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Accounting News And Trends

AUDITING WELFARE PLANS

"Auditing for Health and Welfare Benefit Trust Funds" prepared by the San Francisco Chapter of the Committee On Health And Welfare Funds (THE CALIFORNIA CPA, May 1959) is a follow up to the "Statement of Accounting Principles For Health and Welfare Funds" previously commented upon in this department (May 1959). The article covers such topics as: accounting methods, internal control, scope of examination, and reporting.

In discussing the scope of the examination, the committee points out that there are certain features peculiar to most health and welfare funds that deserve special attention in considering the scope of work to be undertaken. These would include (1) the accounting for contributions and the determination that all amounts properly due the fund from each employer were received and recorded by the fund, (2) the testing of claims for documentation, eligibility, propriety of settlement, etc, and (3) the audit of premiums paid to insurance carriers and, where applicable, brokerage payments to agents.

Where contributions are derived under multi-employer plans considerable care must be exercised in determining whether a fund follows proper procedures and checks to insure that amounts reported to it are proper under controlling agreements. Trustees of health and welfare funds are vitally concerned with the determination that all money owing a fund is collected from employers. Trustees may provide for cross checks on employers' reporting through tests of employment records maintained by labor unions, through employee self-reporting, or through other independent means. They have the duty of assuring themselves that the fund has received amounts properly due it and the responsibility for initial policing of employer reports and payments does not rest with the auditor.

Accordingly, the customary audit by an independent public accountant is not expected to embrace an audit of multi-employer payroll records to support accuracy of reported contributions. The approach and extent of his work will depend a great deal on the system of internal check placed in effect by the trustee. The auditor will frequently have to employ resourcefulness and imagination in ascertaining means whereby he can reasonably form an opinion as to the fairness of contributions reported by employers, without auditing such employers' records. If the internal procedures of the fund or other sources do not provide such means, the practical result is a limitation on the scope of his examination. Confirmation of amounts reported by employers through direct communication with them is frequently used to test the internal control surrounding the recording of such items but, of course, this provides no assurance that the reports are in fact substantially accurate or complete.

Some accountants contend that an opinion can be rendered, without qualification, on financial statements if their auditing procedures have satisfied them as to proper handling of funds received without regard to other funds

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ACCOUNTING NEWS AND TRENDS is conducted by CHARLES L. SAVAGE, CPA. He is presently serving as a member of our Society's Committee on Legislation. Dr. Savage is professor of accounting and chairman of the Business Administration Division of St. Francis College.

which may be legally receivable under terms of applicable collective bargaining agreements. The committee states, however, that the expression of an unqualified opinion by the auditor on the financial statements clearly implies that in his opinion the income from employers' contributions is stated fairly in relation to such financial statements. If the auditor cannot assume this responsibility, he must expressly deny it and explain his reasons for such denial or word his opinion in such a way that he assumes responsibility only as to the fairness of the employers' contributions reported to the fund.

PARTNERSHIP WITH A NON-CPA

The published rulings of the Committee on Professional Conduct of the Illinois Society of CPAs, previously mentioned in this department, continue to present situations of interest. The NEWSLETTER (February, 1959), for example, discusses the matter of a partnership with a non-CPA. In addition to the restriction imposed by the Illinois Accountancy Law which precludes the use of the terms *CPA* or *PA* unless all partners are so qualified, the Committee reminds young practitioners— who most frequently ask the questions—that Rules 3 and 6 bear on this subject. Rule 3 prohibits fee splitting with the laity (i.e., all non-CPAs) while Rule 6 prohibits a member from expressing his opinion unless the financial statements ". . . have been examined by him, a member or employee of his firm, a member of the AICPA . . ." or a CPA of another state. The Committee counsels members that partnerships properly should be only between CPAs who are registered to practice. If, for economic or other reasons, a member contemplates association with a non-CPA, it should be on an employer (the CPA)-employee (the non-CPA) basis.

This Rule 6 is also violated in those cases where practitioners give their opinion on examinations actually made by non-CPAs. The rule specifically prohibits a member from expressing his opinion unless it is, in fact, *his* opinion. The Committee interprets the "examination" referred to in the rule to entail considerably more responsibility than a cursory examination of working papers.

RECOGNITION OF CPA PROFESSION BY STATE LEGISLATURE

With understandable pride, the CPA NEWSLETTER (June 1959) of the California Society of CPAs devoted the major part of its first page to the following recognition of the profession by the Assembly of the State of California:

"WHEREAS, The California Society of Certified Public Accountants, which was organized and incorporated in 1909, will celebrate its Fiftieth Anniversary beginning with its fiscal year June 1, 1959; and

"WHEREAS, During the past half century, the number of certified public accountants in California has grown from a meager 85 in 1909 to over 7,600 in 1959; and

"WHEREAS, Because of the highly specialized and technical services which he renders, the certified public accountant has become increasingly important to the business and financial community in this state and an integral part of the proper functioning of our state and local governments; now, therefore, be it

"RESOLVED by the Assembly of the State of California, That the Members of this House take this opportunity to express their sincere congratulations to The California Society of Certified Public Accountants on the occasion of its Fiftieth Anniversary of service to the people of this state."

Letters to the Editor

DEVELOPING AN EFFECTIVE FEE STRUCTURE

"Time" is the accountant's inventory and he must guard it as well as he recommends safeguards for his client's assets. We in our firm go to great extremes in the accountability of time. For instance, all the hours and salary costs are controlled and distributed to the various categories such as chargeable time to clients, service department, management, staff training, holidays, etc. Individual ledger accounts accounting for the hours, are maintained for each partner and staff member. Various cross controls are maintained to keep this information in balance for each two-week period. Our personnel are required to submit for a two-week period detailed time summaries for each engagement and also time summaries accounting for the eighty hours.

The chargeable hours are posted and controlled to the client "memorandum of billing" and when the engagement is completed these hours are extended at the rates of the individual involved. These rates are standard for all offices. We then arrive at the total standard fee for the respective engagement and determine the percentage of standard to the actual fee. This percentage of standard is the measuring stick which will then start us off on a careful review of our programs.

This memorandum of billing is very useful in the event that an increase in fee is required and we do not hesitate to submit it to the client for his review. We believe the client is impressed by the fact that we ourselves exert such time controls. In this respect, two important tools are used. First, is a Budget and Time Summary which is prepared before the commencement of the engagement, and second is a Progress Report which is prepared weekly during the progress of the audit.

The Budget and Time Summary is printed on a wide columnar work sheet with headings somewhat as follows: cash, receivables, inventories, prepaid expenses, fixed assets, etc. The actual hours required for the previous year's audit by type of work are recorded as the first item on the summary. The budget for the current year's examination is then indicated. This budget is prepared by the senior in charge of the engagement and reviewed by the supervisor or partner or both. We have found that most time reductions can be made at this stage of audit preparation. If the time required in the verification of a particular asset or liability seems unduly high for the previous year, the working papers are reviewed to determine the reason. On the basis of such review, the budgeted forecast hours for such accounts may be reduced considerably.

During the progress of the engagement, each staff accountant's name is noted on the Budget and Time Summary, together with the hours required to perform each phase of the work. Each week the senior in charge prepares a Progress Report. This report shows the total hours on the engagement at the beginning of the week, the hours for the current week, and the total hours to date. This is subtracted from the budgeted hours, and the remaining hours might normally represent how much time would be required to complete the engagement. Just under such remainder is a box captioned "estimated hours to com-

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plete." If these hours are substantially different from the theoretical remainder, the senior is required to make a statement on the Progress Report giving his reasons for the anticipated variations from the budget.

Our experience indicates that effective time control may be achieved by the use of the two reports discussed above.

This may appear to be an insurmountable volume of detail and yet in our Newark office, with a staff of over 100 personnel, all the bookkeeping work, billing, payrolls, time control, and periodic reports to the executive office, are handled by only two girls. We do use a National Cash Register (class 31) machine, but it was not so long ago that we did it all manually.

It is my opinion that only with this strict control of time are we in a position to intelligently set an effective fee structure.

JAMES E. MITCHELL, CPA
(Peat, Marwick, Mitchell & Co.)
Newark, N. J.

A ONE-YEAR INTERNSHIP PROGRAM

I would be interested in learning the reactions of the readers of this magazine to a proposal for the establishment of a one-year internship program. Interested and qualified students, at the end of their junior year, would be given the opportunity to work as interns in suitable public accounting firms for an entire academic

year, obtaining college credits therefor on the basis of performance ratings by a principal in the firm to be reported to the college and the student.

The student would gain work experience superior to that provided by dehydrated case study material in an accounting or auditing laboratory course. He would also gain his experience in a logical and coherent manner, gradually building up, through an indoctrination period and interim work, to a seasonal peak of work and would still have time to take part in the completion and final evaluation of the work done. It is true that the undergraduate course would be lengthened by one year but only for the public accounting program. Yet it may well produce more highly qualified entrants to the profession.

The employer would obtain light junior help at a time when such help would be of use. Moreover, such help would come to him on a one-season trial basis. He would have the choice, at the end of the trial period, to arrange for possible future employment of an intern whose character traits and work habits had proved satisfactory, or to recommend to the intern and the college that consideration be given to a career in private accounting or in some other phase of business. During the internship season the principal in the public accounting firm would keep getting first-hand evidence as to the intern's willingness and ability to learn, his grasp of essentials, his work habits and many other personal characteristics, such as his ability to get along and cooperate with other people. He may even determine the presence and degree of independent thinking on the part of the intern, so vital to the profession, yet so difficult to impart.

JOHN RAPP, CPA
(Fedde & Company)
New York, N. Y.

THE PRESIDENT'S PAGE

The Codes of Professional Conduct

There are many different codes of professional conduct affecting CPAs in the United States today. The American Institute has its own rules of conduct. Each State Society of CPAs has its rules as do many State Boards of Accountancy.

It is interesting to compare these codes and to observe differences in wording. While they differ considerably in detail there is a certain similarity in most of the essentials. In general the essentials in these various codes can be summarized under five main classifications as follows:

PERSONAL STANDARDS—the need for moral character, integrity and competence; the need for observing the confidential relationship with clients.

INDEPENDENCE—the need for complete objectivity in all professional work and for disclosure of relationships that might seem to impair independence.

TECHNICAL STANDARDS—the need for the CPA, in expressing an opinion on financial statements, to conform with generally accepted auditing standards and to clearly indicate the degree of responsibility assumed by him in his examination.

PROHIBITIONS—prohibitions against various practices considered undesirable, such as advertising, solicitation, contingent fees, competitive bidding, sharing fees with persons not engaged in the practice of public accounting, and undertaking services under circumstances discreditable to the profession.

RELATIONS WITH FELLOW PRACTITIONERS—forbidding a member to encroach on another's clients or employees.

For the next few years we may expect an increasing awareness and concern with ethical standards in the accounting profession. This seems clear when we consider what is taking place in the world of professional accounting. We know from practitioners across the country that there is considerable room for expansion of the CPA's services to existing clients—small and large. The CPA may expect to be called upon more and more for tax advice, for business advice and for work in the area of management services. His expertness in specialized matters will be much sought after. We also know there are many new untouched areas, for example, many banks, insurance companies and railroads which do not now use the services of independent accountants.

So if we think of the increasing responsibilities that will devolve on the profession it seems very essential that ethical standards keep pace with them. It also seems essential that the business public know about the CPA's ethical standards. Knowledge that the profession has a code of ethics and some general understanding of what the code says should help the public to understand the value of the services on which it may rely.

While we cannot hope in the foreseeable future for one code of professional conduct that will apply to all CPAs in the various states, it is to be hoped that much more uniformity will be possible than is the case now. Some State Societies are already tackling the matter with a good deal of vigor. The Committee on Professional Conduct of our own Society has made an intensive study of the Society's present rules of professional conduct and recently submitted a proposed revised set of rules to the Board of Directors. These proposed revisions are now being studied by the members of the Board and such revisions should be ready for submission to the membership at an early date.

We may predict, therefore, that all of us will hear a great deal about ethical standards in the next few years. Standards of professional conduct can never be precise. What seems a reasonable code at one time becomes outmoded with the passage of time. It is inevitable as the practice of accounting becomes more complex that ethical questions will arise which have not arisen before. All of us can be helpful in studying the problems involved and in assisting in the educational process that always must precede any change in, or addition to, the rules of conduct.

THOMAS G. HIGGINS,
President

Disclosure in Theory and Practice

By ANDREW BARR, CPA

The Chief Accountant of the SEC explains, by reference to statutes, regulations, and examples from day-to-day work, how the Commission seeks to solve disclosure problems in a manner consistent with accepted accounting procedures and with the disclosure philosophy of the statutes. Some of the major problems considered are the independence of the certifying accountant, the extent to which footnote disclosures can cure statement deficiencies, charges and credits to earned surplus, accrual of past service pension costs, and certain principles of consolidation.

THE SEC administers several statutes enacted by Congress for the protection of the interests of investors and the public.[1] Perhaps the best known of these are the Securities Act of 1933 and the Securities Exchange Act of 1934, the latter having established the Commission as a separate independent agency of the Federal government. These Acts, as well as the Public Utility Holding Company Act of 1935 and the Investment Company Act of 1940, provide penalties for making false and misleading statements under prescribed conditions.[2] With respect to the disclosure aspects of these Acts the Commission has said "It should be understood that the securities laws were designed to facilitate informed investment analyses and prudent and discriminating investment decisions *by the investing public,* and that it is the investor and *not* the Commission who must make the ultimate judgment of the worth of securities offered for sale. The Commission is powerless to pass upon the merits of securities; and assuming proper disclosure of the financial and other information essential to informed investment analysis, the Commission cannot bar the sale of

ANDREW BARR, CPA, is Chief Accountant of the U. S. Securities and Exchange Commission. Mr. Barr has served as president of the Federal Government Accountants Association and vice president of the American Accounting Association. This article has been adapted by the author from a paper presented by him before the Thirty-Sixth Annual Conference of CPAs of the Pacific Northwest, June 1959.

[1] The Securities and Exchange Commission, as a matter of policy, disclaims responsibility for any private publication by any of its employees. The views expressed herein are those of the author and do not necessarily reflect the views of the Commission or of the author's colleagues on the staff of the Commission.

[2] Securities Act of 1933, Sec. 11; Securities Exchange Act of 1934, Sec. 18; Public Utility Holding Company Act of 1935, Sec. 16; Investment Company Act of 1940, Sec. 34.

securities which such analysis may show to be of little or no value."[3]

The basic financial statements are prescribed by the statutes, but the form, extent of detail, classification, and accounting methods to be followed are specifically left to the determination of the Commission.[4] Special powers of the Commission found in Section 19(a) of the 1933 Act include authority to define accounting and trade terms used in the Act and to prescribe the forms in which the required information shall be set forth and the methods to be followed in the preparation of accounts.[5]

These powers have been applied in the adoption of the instructions as to financial statements found in the forms for registration and reporting and in Regulation S-X which prescribes the form and content of the financial statements to be filed under the several Acts. Rules of general application specify that the "financial statements may be filed in such form and order, and may use such generally accepted terminology, as will best indicate their significance and character in the light of the provisions applicable thereto" and that items not material need not be separately set forth in the manner prescribed. However, "the information required with respect to any statement shall be furnished as a minimum requirement to which shall be added such further material information as is necessary to make the required statements, in the light of the circumstances under which they are made, not misleading."[6]

Within the limits of the provisions of the statutes and the rules adopted thereunder after exposure to public comment, we try to solve our disclosure problems in a manner consistent with accepted accounting procedures and the disclosure philosophy of the statutes.

INDEPENDENCE

First of all, a vital safeguard in securing full disclosure is that a professional accountant who is independent of his client review and furnish his opinion on the statements. The concept of independence was well developed and the value of a review by an independent accountant was recognized before the establishment of the Commission. The Securities Act of 1933 provides that the financial statements required to be made available to the public through filing with the Commission shall be certified by "an independent public or certified accountant."[7] The Securities Exchange Act, the Investment Company Act, and the Holding Company Act permit the Commission to require that such statements be accompanied by a certificate of an independent public accountant,[8] and with minor exceptions the Commission's rules do require certification. The Commission's standards of independence are stated in Rule 2-01 of Regulation S-X. The Commission's experience in this area is reported in a number of Accounting Series releases,[9] the most recent one being Accounting Series Release No. 81, issued December 11, 1958. Our inde-

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[3] *The Work of the Securities and Exchange Commission,* p. v. (published by the SEC).

[4] 1933 Act, Items 25 and 26 of Schedule A; 1934 Act, Sec. 13; 1935 Act, Secs. 5 and 15; 1940 Act, Secs. 30 and 31.

[5] House Report No. 85, 73d Congress, 1st Session, p. 25.

[6] Regulation S-X, Rules 3-01, 3-02, 3-06.

[7] Sec. 10(a)(1) (Schedule A, pars. 25, 26).

[8] Securities Exchange Act, Secs. 13a (a)(2), 15(d); Investment Company Act, Sec. 30(e); Holding Company Act, Sec. 14.

[9] See Releases 22, 37, 47 and 81.

pendence requirements have fostered the growth of accountant-client relationships which, I believe, have strengthened the protection afforded investors by independent audits.

The independent status of the certifying accountant is perhaps the most important accounting matter in any filing with the Commission. Experienced practitioners are well aware of this. It should have first attention by the sponsors of a new registrant with the Commission, particularly if the parties involved are unfamiliar with our rules. Discovery after a filing has been made that the certifying accountant is not independent under our rules can result in a substantial delay and interference with well-laid plans as an audit by new accountants will be necessary. Determination of the accountant's status before undertaking the engagement may avoid embarrassment and expense.

DISCLOSURE APPLIED TO FINANCIAL STATEMENTS

Once the question of the independence of the certifying accountant in a new filing is settled satisfactorily, there may be problems of how and to what extent certain transactions should be disclosed. Early contact with the staff when questions of independence or disclosure arise is recommended. Staff considerations of financial statements required to be filed with the Commission may be obtained by telephone or letter or in conference prior to the filing of material. In complicated cases, such as a merger of several companies with different fiscal years, a prefiling conference may result in a solution which will save valuable space in the prospectus or other document. Experienced practitioners usually know when they have a controversial matter of accounting principle. A discussion before filing may avoid later delaying correspondence or conferences when time is vital to the success of an offering.

The development of the meaning of disclosure as applied to financial statements filed with the Commission is marked by two events which should receive some attention before proceeding with a discussion of more recent problems. In October 1934 Northern States Power Company filed a registration statement which disclosed that subsidiaries of the company had written up properties on the basis of an appraisal in excess of $8,000,000 with a corresponding increase in the investment account on the parent's books. This was done in 1924 and in that year and in 1925 the parent company charged unamortized debt discount and expense to capital surplus in the full amount of the appraisal. The staff took exception to this accounting and so did the accountant in a revised certificate accompanying an amendment which explained in a footnote the effect of the accounting. The registration statement was permitted to become effective in this form, but the divided opinion of the Commission was published in a release issued November 21, 1934.[10] The release stated that three Commissioners thought that the circumstances were sufficiently disclosed by the amendment but the other two Commissioners thought that adequate disclosure and treatment required restatement of the affected financial statements and that an explanation should be made as to the company's past accounting practices. This action meant that the majority of the Commission at that time would accept incorrect financial statements rather than require restatement of them provided the footnotes and accountant's certificate provided an ex-

[10] Securities Act Release No. 254.

planation of the improper accounting. The minority were not satisfied with this solution of the disclosure problem. Further official discussion of the problem was promised but did not appear until April 25, 1938, when Accounting Series Release No. 4 was issued.

The Accounting Series was announced on April 1, 1937, with an opinion of the Chief Accountant on the treatment of losses resulting from revaluation of assets—that they should not be charged to capital surplus. This release incorporated in the series a previous release[11] on treatment of Federal income and excess profits taxes and surtax on undistributed profits and announced that these releases initiated "a program for publication, from time to time, of opinions on accounting principles for the purpose of contributing to the development of uniform standards and practice in major accounting questions." Release No. 2 was the first of several on the independence of accountants, and No. 3 dealt with the treatment of investments in subsidiaries in consolidated statements, a question undergoing reexamination today. So we have three releases involving accounting policy, in addition to the Commission's formal opinions on proceedings involving hearings, before the publication of its "administrative policy on financial statements" as Accounting Series Release No. 4. This release says that

> In cases where financial statements filed with this Commission pursuant to its rules and regulations under the Securities Act of 1933 or the Securities Exchange Act of 1934 are prepared in accordance with accounting principles for which there is no substantial authoritative support, such financial statements will be presumed to be misleading or inaccurate despite disclosures contained in the certificate of the accountant or in footnotes to the statements provided the matters involved are material. In cases where there is a difference of opinion between the Commission and the registrant as to the proper principles of accounting to be followed, disclosure will be accepted in lieu of correction of the financial statements themselves only if the points involved are such that there is substantial authoritative support for the practices followed by the registrant and the position of the Commission has not previously been expressed in rules, regulations, or other official releases of the Commission, including the published opinions of its chief accountant.

The first comment I find on this policy was expressed by Commissioner Mathews in his paper before the Institute on Accounting of The Ohio State University on May 20, 1938. The paper discusses the practice of the several professions before the Commission and contains a frank appraisal of the status of accountants at that time and concludes that

> The Commission will assert its influence and exercise its authority to hasten the general acceptance of those principles which have definitely proved their merit, but, because of environmental factors, have not been adopted, and will likewise seek to quicken the abandonment of practices identified with the body of accepted rules and principles which are nevertheless frowned upon by the better thought in accounting.
>
> A recent action of the Commission will serve to illustrate this attitude and approach. Many of you are familiar with the complaints originating in the accounting profession against the use of footnotes to financial statements to explain the use of improper accounting procedures or to correct the effect of statements in the financial statements themselves. Perhaps the growing opposition to the use of footnotes for such a purpose would eventually evolve or develop into a rule of accounting prohibiting and condemning the practice. It would occur, however, only after a long struggle by practitioners against the factors which have in the past on so many occasions tied their hands.

Editorial comment by *The Journal of Accountancy* recognized the statement of policy as an intention of the Commission to assume more respon-

[11] Securities Act of 1933 Release No. 1210, January 6, 1937.

sibility for settling differences of opinion "than formerly because instead of accepting 'full disclosure,' it must decide which party to a controversy is right."[12]

REGULATION S-X AND THE INCOME STATEMENT

The Commission's Regulation S-X which prescribes the form and content of financial statements required to be filed under the several Acts was published February 21, 1940.[13] Prior to this each of the forms for filing included instructions as to the form and content of the financial statements. Between the publication dates of the statement of accounting policy and Regulation S-X, seven Accounting Series releases were published. These included opinions that dividends on treasury stock should not be treated as income, that proceeds of treasury stock in excess of cost do not result in corporate profits or in earned surplus, that surplus by appraisal of properties in excess of cost should be eliminated from the balance sheet of a promotional company, and one listed many of the commonly cited deficiencies in financial statements with a clear invitation for accountants to use more care in the preparation of material for filing. Three releases dealt respectively with the presentation of stock having preferences in involuntary liquidation in excess of par or stated value, treatment of unamortized bond discount and expense applicable to bonds retired prior to maturity with proceeds from sale of capital stock, and the propriety of including in consolidation with domestic corporations foreign subsidiaries whose operations are effected in terms of restricted foreign currencies, or whose assets and operations are endangered by war conditions prevailing abroad. All of these releases and many of those published subsequently represent the application of the policy announced in Release No. 4. Most of these constitute currently effective guides.

Throughout this development period and to the present time it has been Commission policy to seek the advice of those who would be affected by its regulations. This does not mean that in accounting or in other areas everyone can expect to be pleased with the result. As an example of how this works out in practice let me move on about ten years and consider the much debated subject of income and earned surplus which many of you will recognize as Accounting Research Bulletin No. 32 now found in Chapter 8 of the Restatement and Revision of Accounting Research Bulletins (also entitled Accounting Research Bulletin No. 43). The debate over the "all-inclusive" versus "current operating performance" concept of the income statement had gone on for some time. The staff of the Commission had made comprehensive studies of charges and credits to earned surplus[14] and a conference on the subject attended by representatives of various interested organizations had been held at the Commission. As is done today, drafts of the proposed bulletin were discussed with the staff who expressed general agreement with the objective sought but took exception to certain of the proposed exclusions from the income statement. In a most commendable spirit of cooperation the editors of *The Journal of Accountancy* agreed to publish a letter of the Chief Ac-

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[12] *The Journal of Accountancy,* June 1938, p. 464.

[13] Accounting Series Release No. 12.

[14] William W. Werntz and Earle C. King, *The New York Certified Public Accountant,* September 1946, pp. 485-498.

countant in the same issue with the new Bulletin No. 32.[15] After reciting his reasons for disagreeing with certain aspects of the bulletin he said, "Under these circumstances the Commission has authorized the staff to take exception to financial statements which appear to be misleading, even though they reflect the application of Accounting Research Bulletin No. 32."

About this time staff work was begun on a general revision of Regulation S-X. As a first step a draft was prepared in which new terminology recommended by many accountants and public relations men was tried out. The terms "reserves" and "earned surplus" were avoided. The idea was abandoned as being too cumbersome and probably too far ahead of the times. However, we do accept the newer terminology under the provisions of Rule 3-01. Under this rule we also encourage what some wit has called "cent-less" accounting, and figures to the nearest thousand dollars. In the first and subsequent Ford filings the summary of earnings and some other figures were presented to the nearest million dollars.

Another preliminary step in the revision process was to review letters of comment for a substantial period, noting particularly comments cited under authority of Rule 3-06 to which I have referred. Specific provisions were made in the rules for recurring items identified in this review. The resulting first preliminary drafts were exposed to a limited number of persons including members of committees of the American Institute of Certified Public Accountants. A revised draft was sent to approximately 600 persons in September 1949 and the official draft for comment published in the Federal Register went to more than 3,000 persons in July 1950. These last two exposures drew comments from approximately 175 persons. The rule governing the income statement upholds the all-inclusive concept but with a provision that the Commission may permit exceptions.[16] As adopted and now in effect the rule reflects the results of a compromise worked out between the staff and representatives of the Executive Committee of the Institute after their appearance before the Commission. This produced the well-known item 17, Special Items, which has served to bridge the gap between the "all-inclusive" and "operating performance" advocates.

I have taken some time on the matter of the income statement because of its importance and because it is still the source of a large number of comments on financial statements. Many of these are caused by a slavish adherence to advice found in many textbooks that prior year items no matter how insignificant must go directly to earned surplus. The bold print in paragraph 11 of Chapter 8 in Research Bulletin 43 (page 63), when qualified only by exception (a), and our interpretation of Rule 5-03 of Regulation S-X are in agreement on this point that only material items of this type should go directly to surplus. The airlines and some hotel and real estate operators present what might be called regularly recurring "non-recurring" extraordinary items in the nature of substantial gains (usually) or losses on the disposal of or trading of equipment or property; segregation of these items in the income statement after results from operations but befor arriving at net income is an accepted procedure.

EMPLOYMENT COSTS

Accounting for employment costs is a continuing problem with consider-

[15] *The Journal of Accountancy*, January 1948, p. 25.
[16] Regulation S-X, Rule 5-03; see also Accounting Series Release No. 70.

able difference of opinion as to the solution in accounting theory as well as the degree of disclosure in practice. Problems have arisen, and some persist despite efforts at a solution, in the accounting and reporting for pensions and deferred compensation plans.

The Institute's bulletins have not dealt with the deferred compensation problem. In fact Bulletin No. 47 on Accounting for Costs of Pension Plans states specifically that "It does not include profit-sharing plans or deferred-compensation contracts with individuals." As a matter of principle it appears to us that in most cases deferred compensation should be provided for prior to the individuals' retirement and assumption of a status as consultants and advisors. The amounts involved are not material in most cases, perhaps, but this should not be used as a reason for omitting proper accruals.

The business recession of 1958 set the stage for difficulties under Bulletin 47 dealing with the accounting for pension costs. With net incomes staggering from decreased business activity, corporate managements exerted great pressures to reduce costs for both those requiring cash expenditures and book accruals. The revenue deduction for pension costs varies widely, depending upon the assumptions made by the actuary. The determination of a fair amount for pension costs under a systematic plan is in the controversial area of securing the data on which the accounting is to be based.

The case of the financial report of United States Steel Corporation for 1958 indicates current controversy on what the generally accepted accounting principle should be.[17] The corporation made a charge to income of $144 million for pension costs in 1958 compared with $265 million for 1957. The certifying accountants stated that the charge, while not equal to the current service costs accrued during the year, is more than sufficient when added to current service costs accrued in prior years to equal all current service costs accrued since the adoption of the plan in 1950. The certifying accountants in this case noted in their certificate a change in the company's determination of the amount of cash paid to the trustee, disclosed the effect on net income and that the payments for the current and prior years were not comparable, but concluded in their opinion that generally accepted accounting principles were consistently applied for the five years. Other accountants have indicated that they would take an exception to such action since they did not consider that a generally accepted accounting principle had been followed when a charge to income is not made for the full amount of the current service costs accrued. A third group has indicated that under Bulletin 47 no explanation need be given in the certificate as long as footnote disclosure sufficient for statement comparability is made. This is a subject which requires further study as to what constitutes a generally accepted accounting principle with respect to this matter.

Representatives of the profession are well aware that progress in this area must be made. Often it is urged that experience is necessary in dealing with a new problem before a sound principle can be derived. There is merit in this approach, but in the meantime good financial reporting and fair disclosure require that the items be handled within the existing framework of generally accepted accounting principles.

INVENTORIES

Before leaving the general subject of

[17] See "News Report," *The Journal of Accountancy*, April 1959, p. 8.

income statement problems we should recognize that inventories continue to cause trouble of various kinds. In the realm of theory Lifo looms large. Ten years ago we were close to agreement that an alternative valuation should be disclosed in a footnote or otherwise when Lifo was used in the accounts. Although some companies have volunteered this information with varying degrees of clarity, others resisted on the grounds of cost to develop the information, feared the effect on their tax status or the alleged misleading nature of the figures that would be produced. The Libby, McNeill & Libby proxy contest of several years ago demonstrates that the subject can be used to confuse the uninformed.[18] Recently there seems to be a renewed interest in the subject prompted,it appears, by a desire to gain the benefits of more current values for balance sheet purposes and still retain the advantages in determining income. More uniform disclosure in this matter should be encouraged, but we are not ready to accept a balance sheet adjustment to the Lifo inventories net of tax effect reflected as an increase in working capital and stockholders' equity. We have not objected to parenthetical disclosure, however, in the face of the balance sheet.

Another inventory problem arises when one company buys another at a substantial discount from underlying book value, resulting in an allocation of this discount to various balance sheet items including inventories. When the inventories are sold in normal course soon after acquisition an unusual non-recurring profit may be realized. We have had several cases in which this was so significant that the non-recurring gain was removed from gross profit and reported below with a clear explanation of the source of the gain.

PRINCIPLES OF CONSOLIDATION

In the area of consolidated statements there remain many unresolved problems. One question which gives us considerable difficulty is when may a subsidiary be omitted from consolidation with the parent company. We have generally taken the view that the investor can most readily appraise the financial condition of a company and of his investment in the company if all majority-owned subsidiaries are consolidated. There are a number of definite exceptions to this rule. But the inclusion of profitable subsidiaries and exclusion of the unprofitable, as was urged upon us recently on the grounds that the excluded subsidiaries were not significant, is not one of the exceptions. Our rules do not permit an industrial or commercial company to consolidate a bank or a life insurance company due to the complete dissimilarity of operations and because the latter's resources would not be available to the parent companies. It may be misleading to consolidate foreign subsidiaries where rigid foreign exchange controls are employed or where a devaluation of the currency has recently been experienced or is imminent. Recently a financial writer criticised this practice on the grounds that an element in determining the strength of the company was concealed. When subsidiaries are excluded from consolidation for valid reasons our rules require that the parent's equity in the underlying assets and earnings be disclosed in footnotes.

However, where an operating function of a company is separated from the parent and performed by a subsidiary, ordinarily such subsidiary should be included in the consolidated statement. The real estate subsidiary, normally heavy with debt, is an example. Omitting the real estate sub-

[18] *SEC* v. *May*, 134 F. Supp. 247 (1955) Aff'd, 229 F. 2d 123 (1956).

sidiary and its debt from consolidation results in a "clean balance sheet" but does not disclose the impact of the debt on the consolidation. On the other hand, where the subsidiary is consolidated the reader is properly informed as to the debt for which the parent company's rental payments are usually collateral.

A similar question is raised when a property used by the registrant is acquired subject to a mortgage. In a recent utility filing it was urged that the net equity should be shown among the assets by disclosing cost of the building and deducting the reserve for depreciation and the balance due on the mortgage. Operations of the building were included in the company and consolidated income statements. Under these circumstances we insisted that the building be shown under property and the mortgage payable as a separate item among the liabilities with appropriate descriptions to disclose the status of ownership.

Some accountants and company representatives have contended that a finance subsidiary should not be consolidated, even where it is financing primarily sales of the parent, on the ground that the finance subsidiary's operations are of a banking nature and are too unlike the operations of the parent to make it advisable to consolidate. The typical finance company has a heavy debt/equity ratio, although the argument is made here that this should not be considered where the parent has no liability on the accounts. In my opinion, where the finance company is handling primarily the accounts of the parent and affiliates, it constitutes an integrated part of total operations and should be consolidated even though the parent is not subject to recourse on the accounts.

Often the buying or selling functions of a firm are performed by a subsidiary. The "buying subsidiary" acting in the capacity of purchasing agent for raw materials often carries a substantial part of the raw materials inventory for the combination and in order that the total resources of the combination be reported, the subsidiary should be consolidated. In addition, debt is customarily used extensively with the inventory pledged as collateral and this constitutes a further need for consolidation.

As an argument against consolidation of these companies their representatives often note that creditors of the buying subsidiaries or of the finance companies do not want consolidated statements. Their argument is that specific assets pledged as collateral for the debt are not segregated. Compliance with our requirements will produce this information.[19] Presentation of separate subsidiary statements to the bankers, insurance companies and other credit grantors in need of such statements is not precluded.

Some industrial companies acquire or establish subsidiaries for the production of their raw materials. Where this stage of vertical integration is not common in the industry, some companies are reluctant to consolidate such subsidiaries and argue that their statements would no longer be comparable with those of other firms in the industry. With the possible rare exception it would appear that consolidation is in order.

PROMOTIONAL COMPANIES

The problem of accounting for assets received in exchange for stock in promotional companies occurred frequently in the early years of the Commission and led to the adoption of Article 5A of Regulation S-X in which no values are extended for assets so

[19] Regulation S-X, Rule 3-19(a).

acquired. The problem of the donation back of shares issued in these circumstances was considered in an early decision[20] in which the Commission discussed statutory law and court decisions and then said: "With the question of whether or not stock reacquired under these circumstances is true treasury stock and hence is to be regarded as fully paid and nonassessable, this Commission in this case has no concern; but under the standards of truthfulness demanded by the Securities Act, such an entry cannot be regarded as otherwise than untrue and misleading."

In another early case the Commission questioned the value of services rendered in exchange for stock and said: "Statutory provisions in the state of incorporation making values fixed by directors conclusive for certain purposes in the absence of fraud, cannot foreclose this Commission's inquiry as to the truthfulness of a statement that a corporation has received services of a certain value, reasonably determined, nor prevent such a statement from being tested for truth under the standards set by the Securities Act." [21]

Situations similar to these are occurring today with a new generation of promotors and their professional advisers who may think that the circumstances are different or more likely they are not aware of the stop order cases in the first years of the Securities Act. An example is a case a year ago in which an old company was the vehicle for a new promotional uranium venture.[22] Even the corporate name was misleading.

The financial statements were prepared in an effort to comply with Article 5A of Regulation S-X and were accompanied by a most revealing certificate. Significant facts revealed were that the company's records were destroyed by fire in 1939 and that the company had had no operations from that date to May 1, 1957. In these circumstances the accountant reported that he had inspected the properties and obtained engineering appraisals of the old tunnels, power house installations and water rights and set up his statement of assets using values so determined, but as for new mining claims acquired for stock he assigned no dollar values. The prospectus as filed said that "The business intended to be carried on by the company is that of a public utility and the operation of the firm's mining properties." After the opinion in the proceeding was published a revised prospectus for the company under its new and more informative name became effective on August 13, 1958. This document stated that "This is an exploratory mining venture and no assurance can be given the prospective investor that commercial ore bodies will be discovered." As to the power plant and water rights the new prospectus said: "It is not the present intent of the management of the company to utilize the hydroelectric facilities or the water rights at the present time as there is no evidence of any demand for the power." The statement of assets was revised to reflect this situation. In the statement furnished with the original filing the principal properties were set forth as follows:

Hydroelectric Power Plant—	
Appraised value on present day replacement costs — approximately	$ 450,000
Water rights — appraised value..	1,000,000
Mining claims—at necessary cost to patent	232,272
Claims from promotors in exchange for stock	969,395 shares
Development work on mining Claims—	
Engineer's appraisal of present day costs per foot	438,615

[20] *In the Matter of Unity Gold Corporation,* 1 SEC 25 (1934).
[21] *In the Matter of Brandy-Wine Brewing Company,* 1 SEC 123 (1935).
[22] *In the Matter of The Fall River Power Company,* S. A. Rel. 3932, June 4, 1958.

Total dollars assigned to these items (including items assigned nominal values of $1 each)........	$2,120,887
Recent cash items amounted to..	26,730
Total dollar valuation....................	$2,147,617

As revised nearly two years later the cash items extended at $38,506 and all of the old properties were identified by descriptions and references to footnotes and one group was assigned a nominal value of $1.00. All of these were shown as encumbered by a $500,000 mortgage to the former owner who was to receive 90 percent of the first proceeds from the public offer up to the $500,000. The Commission's opinion disclosed that this individual had acquired all of these old properties for about $100,000 in 1944.

The desire to use appraisals as the basis for writing up assets is strong in sponsors of small companies with unimpressive earnings records. This situation is encountered frequently in exempt offerings under Regulation A. A standard pattern seems to be a restatement upward of the fixed assets shortly before the offering. When we receive the material for review the balance sheet reflects the appraisal but the reported earnings do not include depreciation on the addition to the plant values. Removal of the write-up is requested. It is not unusual to find that the appraisal surplus has been capitalized by a stock dividend. Where this is legal under state law we request a restatement of the property at cost and the excess due to the appraisal must be shown as a deduction in the equity section of the balance sheet. In a recent case the write-up was limited to the exact amount of a 100% stock dividend but a note disclosed that this was conservative since the appraisal revealed an additional value of nearly that much more! All dollar amounts of this total appraisal were removed and book values per share calculated on the written-up values were deleted before the offering circular was acceptable.

I hope that this discussion has made it clear that we recognize that we must first attempt to understand the business facts and then apply what we find to be the appropriate accounting principles. Accounting is still a matter of opinion and judgment, and good results depend upon the high standards of business ethics and professional conduct displayed by management and certifying accountants.

THE REPUTATION OF A PROFESSION

Many of you graduates are preparing to follow Certified Public Accounting as your life's work. Let each of you remember that you will hold in your hands the reputation of a profession which in these last years—and in large part by the unremitting efforts of your predecessors—has been raised to a dignity equal to that of the Law, Medicine or any other. It will be yours either to enhance or to sully,—and remember that your conduct will reflect on all those who share your profession with you.

From an address by Lieutenant Governor MALCOLM WILSON at the 1959 Commencement Exercises of Pace College

Balance Sheet Treatment of Deferred Tax Credits

A LETTER FROM
THE AICPA'S PRESIDENT

June 18, 1959

TO THE MEMBERS OF THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

GENTLEMEN:

I am sending you herewith a letter from the Committee on Accounting Procedure, dated April 15, 1959, in regard to balance sheet treatment of the credit for deferred income taxes arising from accounting recognition of the use of the liberalized methods of depreciation authorized by Section 167 of the Internal Revenue Code for income tax purposes but not for accounting purposes.

On April 8, 1959, the Institute's Research Director, Mr. Carman G. Blough, appeared as a witness at a Securities and Exchange Commission rule-making hearing—a public hearing of which a transcript is available to any member of the public. At that hearing he testified, among other things, that the letter dated April 15, a copy of which is sent you herewith, had been approved by the Committee on Accounting Procedure and was about to be sent out. Also he read into the public record of that hearing the significant portion of the letter.

Mailing of this letter has been delayed because of an injunction originally obtained on April 15 of this year, without notice and without a hearing, by Appalachian Power Company, Ohio Power Company, and Indiana & Michigan Electric Company from the United States District Court for the Southern District of New York.

The injunction forbade the mailing of the letter without first exposing it for comment to those to whom the exposure draft of Accounting Research Bulletin No. 44 (Revised) was submitted and deferring its mailing until at least sixty days after such exposure.

Later a hearing was held by the District Court on May 7. On May 20, that Court filed an opinion deciding that the injunction should be dissolved and the suit dismissed and advising counsel to submit, on notice, an appropriate order to put the decision in effect. On May 25 an order was entered to the effect that the suit should be dismissed. However, the District Court at that time enjoined the mailing of the letter pending a hearing by the Court of Appeals on a motion for an injunction, provided such a motion were filed in the Court of Appeals no later than June 1. Such a motion was duly filed and on June 17 that Court affirmed the ruling of the lower Court that the suit should be dismissed and dissolved the injunction.

Thus, although the significant portions of the letter of April 15 have been a matter of public record since April 8, we have been unable to send you a copy of the letter until now because of the injunction proceeding.

Very truly yours,

L. H. PENNEY
President

A LETTER FROM THE AICPA'S COMMITTEE ON ACCOUNTING PROCEDURE

April 15, 1959

TO THE MEMBERS OF THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

GENTLEMEN:

Question has been raised with respect to the intent of the committee on accounting procedure in using the phrase "a deferred tax account" in Accounting Research Bulletin No. 44 (revised), *Declining-balance Depreciation,* to indicate the account to be credited for the amount of the deferred income tax (see paragraphs 4 and 5).

The committee used the phrase in its ordinary connotation of an account to be shown in the balance sheet as a liability or a deferred credit A provision in recognition of the deferral of income taxes, being required for the proper determination of net income, should not at the same time result in a credit to earned surplus or to any other account included in the stockholders' equity section of the balance sheet.

Three of the twenty-one members of the Committee, Messrs. Jennings, Powell and Staub, dissented to the issuance at this time of any letter interpreting Accounting Research Bulletin No. 44 (revised).

COMMITTEE ON ACCOUNTING PROCEDURE

By WILLIAM W. WERNTZ, *Chairman*

WHOLE-DOLLAR ACCOUNTING

All accountants owe their clients the duty to be familiar with the whole-dollar accounting method. In our daily work, we are aware of the need for such a method as a work-simplification idea designed to increase employee productivity in accounting operations.

The subject logically ties in with management services relating to office methods and procedures. Whole-dollar accounting because of its simplicity of principle and use lends itself to a first suggestion for improvement in clients' office procedures and methods. This work-simplification method could then be either a separate service in conjunction with other management services or the starting point for a larger management services assignment for many clients. . . .

Apparently this method of whole-dollar accounting is little used because of lack of information relative to the method and its successful use. As accountants and management consultants, we should familiarize ourselves with the method, educate our clients in its cost savings, and assist in its installation.

HENRY J. GRISWOLD, "Whole-Dollar Accounting," NEWS BULLETIN (Mass. Society of CPAs), June 1959

City Audits by Mail

By LAWRENCE L. KATES, CPA, and MAX ZIMERING, CPA

Since 1956 the City of New York has adopted the practice of auditing the general business and sales tax returns of selected taxpayers on the basis of financial information contained in questionnaires. This article explains how the City audits by mail and covers the various methods used in determining "adjusted sales." It also sets forth the relief measures available to taxpayers who object to the findings of the Bureau of Excise Taxes.

THE mail audit questionnaire was originally conceived in 1934 for use by the Bulk Sales Unit of the Comptroller's Office of the City of New York, and is still being used by this office. The "Sales and Business Tax Questionnaire," which has been in effect since September 1956, permits the Bureau of Excise Taxes to audit taxpayers' "gross receipts" and sales tax returns from financial information submitted by them. This type of audit makes it possible to conclude examinations more expeditiously and thus enables the City to examine many more taxpayers than in the past.

LAWRENCE L. KATES, CPA, a member of our Society's Committee on Municipal and Local Taxation, is a partner in the firm of Goldberg, Gilbert Co., Certified Public Accountants.

MAX ZIMERING, CPA, an Associate Professor of Accounting at the Baruch School of Business and Public Administration, City College of New York, was formerly a member of our Society's Committee on Municipal and Local Taxation. Mr. Zimering is also engaged in the practice of public accounting on his own account.

During March 1959, several members of the New York State Society of Certified Public Accountants' Committee on Municipal and Local Taxation, including the writers, met with Mr. Louis Goodgold, Assistant to the Special Deputy Comptroller, for the purpose of discussing the questionnaire.

At this meeting, we were advised that "audits by mail" had been initiated because of various complaints filed by trade associations and large taxpayers who alleged that many small taxpayers were not filing accurate tax returns and were never examined by the Bureau. Inasmuch as these small businessmen did not pay their rightful taxes, those who did so were required to bear more than their share of the over-all tax burden.

Our City has approximately 350,000 registered taxpayers who file gross receipts and sales tax returns. Since perhaps only 2 to 4 percent of the returns filed are examined, it is logical to assume that many small taxpayers may be overlooked. Through the medium of the mail audit questionnaire, the City is now auditing about 500

additional taxpayers per month, and is obtaining extra revenue of about $600,000 per year from this source. This source of revenue will probably increase as the audits are expanded to cover new businesses.

TAXPAYERS PRESENTLY SUBJECT TO AUDITS BY MAIL

The Bureau has organized a special group, known as the Questionnaire Unit, which functions under the jurisdiction of the Office Audit Branch. This unit mails questionnaires to taxpayers whose gross receipts are less than $100,000. Taxpayers whose gross receipts are between $100,000 and $125,000 will also be included if the total deductions are less than 10 percent. The following types of businesses are presently included:

Candy and confectionary stores. Grocery stores (other than chain stores). Cafeterias, diners, delicatessens and luncheonettes. Package liquor stores. Children's and infants' wear stores. Dry goods and general merchandise. Family and clothing stores. Men's furnishing stores. Retail shoe stores. Women's accessory and specialty stores. Women's ready-to-wear stores. Independent variety stores. Book stores. Gift, novelty, greeting cards and souvenir stores. Hardware stores. Paint and wallpaper stores. Toy dealers. Furniture stores. Taxicab operators.

The Bureau mails a letter and questionnaire to the taxpayer, and requests that the information be submitted within twenty days on threat of a detailed audit if the taxpayer fails to comply. The letter usually requests the taxpayer to submit copies of his sales tax returns for three prior quarterly periods; business (i.e., gross receipts) tax returns for two prior years; and cancelled checks or other evidence of payment of taxes due. The Bureau has advised the Committee that it will accept photostatic copies of the above documents in lieu of the originals.

The Questionnaire requests details as to the following:

1. Date business commenced.
2. If purchased, date, names and addresses of persons from whom acquired.
3. Average number of employees.
4. Gross receipts from sales.
5. Taxable receipts from sales.
6. Average annual inventories.
7. Merchandise purchases.
8. Salaries and wages paid to employees.
9. Salaries, wages and drawings paid to owners and partners.
10. Annual rent.
11. Other expenses, in detail (exclusive of federal income taxes).
12. Taxes paid on: (a) sales tax for four prior quarterly periods; and (b) business tax for three preceding years.

CITY'S AUDIT PROCEDURE

An auditor is assigned to fill in the information submitted on a "special check sheet." He is equipped with a printed form which contains percentage mark-up figures for all of the factors used in determining adjusted taxable sales for each of the different types of businesses covered by the questionnaire. These percentages are derived from external indices and are lower than the Dun & Bradstreet industry percentages.

The following methods are used to determine adjusted sales:

1. A percentage of mark-up is applied to the merchandise purchases. The mark-up, in dollars, is then added to the purchases to arrive at the adjusted sales.

2. The average annual inventory multiplied by the inventory turnover equals the cost of goods sold. Applying the percentage of mark-up to the cost of goods sold yields the adjusted sales.

3. The "profit on overhead" method combines the annual rent with the

salaries of employees, salaries or drawings of owners or partners, and all other expenses. The total of these items equals the gross profit. A percentage is then applied to the gross profit to determine the adjusted sales for each year.

The average adjusted sales of the above three methods or the highest of these methods may be used as the adjusted sales. The percentage of taxable sales is then determined either by audit or by the application of a predetermined percent, depending upon the type of business involved.

Where there are out-of-city sales the taxpayer is requested to submit shipping receipts or other evidence of delivery to these customers. If the taxpayer is unable to produce such documents, then the Bureau communicates with the out-of-city customers and sets up a percentage figure based on the responses received from such customers.

SPECIAL QUESTIONNAIRE FOR THE TAXICAB INDUSTRY

The information requested in this questionnaire is similar to the regular audit described above and calls for details as to the number of employees, gross receipts from operations, commissions and other expenses paid, etc. However, the basis used in determining taxable receipts is somewhat different. The adjusted sales are arrived at by applying a predetermined percentage to the commissions or the expenses. Each of these figures is then divided by the percentage to yield the gross sales.

ASSESSMENTS

The difference between the tax paid and the tax determined to be due after audit based on the questionnaire is assessed with interest. The Bureau then mails a "Proposed Assessment Notice" to the taxpayer, accompanied by a "Consent and Waiver Form." The taxpayer can either sign this consent and pay the additional tax due or, if he objects to the Bureau's findings, he can request a conference for a further discussion of the matter. If he is unable to reach an agreement in conference, the case is then assigned to the field for a regular audit.

ILLUSTRATIVE CASES

The two cases described below represent actual experiences of several accountants with the mail audit questionnaire.

The first case involved a taxpayer who operates a subway stand and sells magazines, newspapers, cigars and cigarettes. The accountant completed the questionnaire and submitted it to the Bureau. Thereafter, the City proposed that the taxpayer pay an additional $900 in taxes. Since the accountant disagreed with this proposal, he requested that the case be assigned to a field auditor. The examiner listed one month's bills and increased the deficiency to $1,200. The accountant then countered by submitting another month's bills, which produced a deficiency of $600. Inasmuch as the parties at interest were unable to reach an agreement, an informal conference was scheduled and the case was ultimately closed with a tax deficiency of over $1,000.

The other case involved a taxpayer who conducts a retail dress business from his home. The questionnaire was submitted and the City proposed an assessment which was not acceptable. The taxpayer requested an informal conference. At this meeting, the conferee held that the taxpayer's cost of living exceeded the income reported and that the gross receipts were inadequate to cover. The accountant then presented evidence indicating that the rental paid covered

both the business operations and the personal living quarters of the taxpayer. The conferee then reviewed the entire file and agreed that the "mark-up" appeared adequate and the proposed assessment was unjust. The examiner then discussed his findings with his supervisor who offered a compromise settlement which was not acceptable. The case was then assigned to the field and the examiner agreed to reduce the tax to 5 percent of the original assessment and, on further conference, the case was finally closed with no assessment.

SOME RECOMMENDATIONS

During the past two years, our Society's Committee on Municipal and Local Taxation has made an exhaustive study of the mail audit questionnaire. A subcommittee prepared a report and submitted its recommendations to the full committee. During March 1959, several members of this committee, including the writers, met with officials of the Office of the Comptroller to discuss our recommendations. A summary of the more important subjects covered is here submitted:

Use of the Mail Audit Questionnaire, solely as a guide to the Bureau to enable them to formulate field audit policies, is acceptable. However, the Committee objects to the substitution of a mailed questionnaire for an individualized tax audit on the following grounds:

1. The questionnaire is aimed at the small taxpayer with receipts under $100,000. Total sales are arrived at by the Bureau directly from the filled-in qustionnaire, by means of a standardized gross profit percentage on purchases, or a profit percentage on overhead or on the basis of inventory turnovers. Basing a proposed assessment for small taxpayers on "industry" or adjusted Dun & Bradstreet percentages and ratios, rather than on their actual books and records, is objectionable. Small taxpayers by the very nature of their operation, cannot conform to any industry norm. Furthermore, predicating an annual sales figure on an arbitrary percentage, and then further exaggerating the inadequacy of the audit by projecting the arbitrary percentage of error over a three-year audit period, is also objectionable.

2. The calculation of a proposed deficiency is based upon a finding of "unreported sales" which the taxpayer is asked to admit under threat of immediate field audit. Acceptance of such a deficiency by a taxpayer may constitute an unwarranted admission of fraud. To avoid any stigma of fraud, the wording on the acceptance form should make it sufficiently clear that the finding of unreported sales is based upon an industry percentage, which was not arrived at from the taxpayer's own books and records. (It should be noted that the bureau has agreed to modify its language in this respect, as recommended by the Committee.)

3. The statement of proposed deficiency, as mailed to the taxpayer, leaves him completely in the dark with reference to the method of calculation used by the Bureau. Inasmuch as most taxpayers receiving the questionnaire will be small businesses and will not be in a financial position to engage tax counsel, we feel it mandatory that not only the method of calculating the deficiency be clearly outlined in the notification, but that the taxpayer be fully acquainted with all of his rights and privileges in contesting the proposed deficiencies.

4. The Committee feels that the filling out of detailed information called for by the questionnaire, in addition to the tax form, is an undue burden on small businesses. If the

information requested is deemed necessary by the Bureau for proper verification of returns, then such information should be called for on the original tax form.

We should, therefore, like to stress the importance of maintaining complete and accurate records. These records may assist materially in obtaining a more reasonable settlement in a tax examination.

CONCLUSIONS

Since the mail audit questionnaire is a procedure restricted to small taxpayers and does not usually involve substantial tax deficiencies, experience in this field has been limited. Our Committee intends to arrange for other meetings with the Bureau to discuss further modification of the questionnaire and to attempt to define more clearly the limits of the City's authority in conducting such audits. Meanwhile, the following are some conclusions reached by the authors of this article which the practitioner may find useful as guides in audits-by-mail situations:

1. A taxpayer is not legally obligated to submit the questionnaire to the Bureau. If the required information is not readily available, or if the taxpayer prefers an office or field audit, he has a right to so advise the Bureau.

2. If the taxpayer's records are complete and the preparation of the questionnaire does not pose too much of a problem, it is recommended that it be submitted.

3. If the proposed deficiency is not acceptable, a conference or audit based upon an examination of the taxpayer's records can still be requested.

4. Accurate and complete records should be maintained. This will be of great benefit if the examiner's findings, based on test-checks, appear unreasonable.

5. A taxpayer should consider carefully before he accepts a proposed deficiency only because the proposed deficiency is nominal. It is important to remember that such acceptance sets a precedent for future examinations.

The Quality of Independence

Independence has been described many times as a state of mind. It is an intellectual quality, inseparable from professional integrity, and both the foundation and keystone of the public accounting profession. It is the chief reason for the growth of the profession. The young man entering the profession, even though of unquestionable character, must be taught what independence means when applied to his work. He must learn by example and by constant observation so that gradually he will accumulate a store of understanding to the point where this intangible quality becomes instinctive and a part of him.

Burnell H. DeVos, "Independence,"
The Price Waterhouse Review, Summer 1959

Direct Costing Approaches to Management Decisions

By William E. Arnstein, CPA

The use of an orthodox accounting system need not preclude the employment of direct costing techniques for decision-making. The author discusses various methods of separating fixed from variable costs and illustrates how the resulting information can be used by management in making decisions as to product line abandonment or promotion, make-or-buy, capital expenditures, and similar managerial problems.

As recently as ten years ago few readers of this magazine, including the author of this article, would have recognized the phrase "direct costing" although there were several companies which had been using the system for some time. However, in the last few years there has been a great deal of discussion about the advantages and disadvantages of manufacturing companies adopting direct costing as a system of accounting. Although there are several definitions of direct costing, for purposes of this article it may be described as a method of costing under which only variable costs are charged to products or departments and all fixed costs are shown as one figure which is charged against the marginal profit, i.e., the excess of the selling price of products over the variable costs of such products. Much of the argument that has raged on the propriety of direct costing as a system of accounting has centered on the valuation of inventories and, accordingly, has been confined for the most part to a discussion of whether fixed *manufacturing* costs should be allocated to products. However, direct costing also involves the charging of variable selling and administrative costs to products even though they actually do not affect inventories since they have not been incurred at the time the goods reach finished stock.

WILLIAM E. ARNSTEIN, CPA, is a member of our Society's Committee on Management Advisory Services and of the Society for the Advancement of Management. Mr. Arnstein, who is a graduate engineer, is a partner in the firm of S. D. Leidesdorf & Co., Certified Public Accountants.

PROS AND CONS OF DIRECT COSTING AS A SYSTEM

It is not the purpose of this article to review the voluminous material already published which attacks or defends direct costing. However, it seems reasonably obvious that the basic purpose of accounting is to help management run its business at the maximum profit. Experience has indicated that manufacturing companies will obtain more useful information in

helping them make decisions from direct costs than they will be able to get from orthodox costs. Also, direct costing saves much clerical labor by eliminating the need to allocate fixed expenses. However, accounting figures are used by a great many people, both inside and outside the company, who are not accountants. These people have grown accustomed to the normal relationships of certain figures over a period of years, and any change in accounting conventions which substitutes entirely different figures under very similar labels is bound to be confusing. With certain exceptions, it may be said that this confusion will cause more harm than is warranted by the good resulting from the better information available under direct costing. Furthermore, under certain government regulations, direct costing is not an acceptable method of accounting and annual statements must be adjusted to an orthodox basis. Accordingly, it is probable that most companies would be hurt if they adopted direct costing for their basic records, at least until it is generally better understood and accepted, but in the meantime they can help themselves by obtaining the information which a direct costing system throws off automatically while continuing to keep their books according to conventional accounting practices. In passing it might be mentioned that many companies are today using a standard cost system which carefully differentiates both in unit costs and departmental costs between fixed and variable overhead. Such systems have been in successful use for a long time and, if properly used, will provide much of the data needed for management decisions.

The remainder of this article will be devoted to a discussion of methods of separating fixed from variable costs without keeping the books of a company on a direct costing basis, and to a presentation of some illustrations of how the resulting information can best be used.

SEPARATING FIXED FROM VARIABLE COSTS

Most accountants have at one time or another been faced with the problem of determining what portion of a company's costs or what portion of a particular account is fixed (i.e., does not vary with changes in production), and what portion is proportionately variable with production. Before discussing the most acceptable methods of solving this problem, it is important to mention that fixed costs are never truly fixed in the sense that nothing can change them. Such items as executive salaries, real estate taxes, and depreciation are generally considered examples of fixed costs. However, executive salaries can be moved up or down and if volume increases sufficiently more executives may have to be added or, if volume falls off, some may have to be dropped. Similarly, real estate taxes are fixed only as long as the same space is kept, and depreciation is fixed only as long as the same buildings and the same equipment within the buildings are owned. For purposes of the present discussion fixed expenses will be considered as those which in all likelihood will remain relatively fixed in amount within the limits of the changes in amounts of production being contemplated.

ANALYTICAL APPROACH

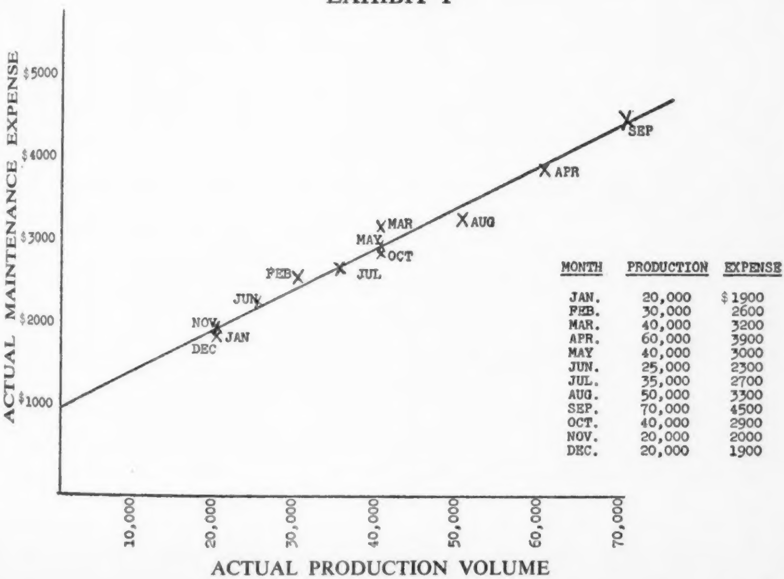
The first and most common method of separating fixed from variable expenses is at best an estimate but usually will be sufficiently accurate for the uses to which the information will be put. It consists merely of an analysis or study of what each account within each department contains. For example, after it is known that maintenance expense consists of the salary

of the maintenance foreman, one chief electrician, one chief millwright, one chief painter, and seventeen assistant electricians, millwrights, and painters, their fringe benefits, the depreciation on machine shop equipment, the lubricating oil, perishable tools and paint used in their work, and how many dollars is represented by each of these labels, it is not too difficult to determine, with the help of the maintenance foreman, what the effect would be on each of these expense classifications if production dropped 10 percent or conversely if it increased 10 percent. Exactly the same approach can be used in analyzing any other account. The most important consideration is to be sure that the estimating is done in conjunction with someone who is actually familiar with the pattern of past variations in expenses as production varied.

THE GRAPHICAL AND MATHEMATICAL METHODS

The second method of separating fixed from variable expenses consists of taking monthly production and expense figures (the expense can be either by account or groups of accounts) and determining how expense actually has varied with production. Past monthly expense figures at various levels of production can be plotted on graph paper, with production along the horizontal axis, and the expense for the month along the vertical axis. Ordinarily the plotted points will be found to be a series of dots which lie more or less along a straight line. A straight line can be drawn by eye to fit these points. Fixed expense corresponds to the distance above the horizontal axis where this line intersects the vertical axis (zero production). The slope of the line (ratio of vertical increment to horizontal increment) represents the variable expense per unit of production. Exhibit I shows such a chart based on the figures shown in the table in the lower right hand corner.

EXHIBIT I



MONTH	PRODUCTION	EXPENSE
JAN.	20,000	$1900
FEB.	30,000	2600
MAR.	40,000	3200
APR.	60,000	3900
MAY	40,000	3000
JUN.	25,000	2300
JUL.	35,000	2700
AUG.	50,000	3300
SEP.	70,000	4500
OCT.	40,000	2900
NOV.	20,000	2000
DEC.	20,000	1900

While a line which is drawn by eye may be sufficiently accurate for the purposes at hand, it may cause controversy because someone else may feel that some other line would fit the points better. This uncertainty can be eliminated by applying a mathematical formula to the table which will result in the proper equation for the straight line. The technique used is usually referred to as the "method of least squares." Exhibit II illustrates the use of this method. It should be noted that in the equation in Exhibit II, "a" is the fixed expense and "b" is the amount of variable expense which must be added for each unit of production, "x".

EXHIBIT II

Example of Use of Least-Squares Technique In Arriving at Fixed and Variable Elements of an Expense Account

Month	Actual Production In Pcs. x (000)	Actual Expense y (000)	x^2	xy
January	20	$ 1.9	400	38.0
February	30	2.6	900	78.0
March	40	3.2	1600	128.0
April	60	3.9	3600	234.0
May	40	3.0	1600	120.0
June	25	2.3	625	57.5
July	35	2.7	1225	94.5
August	50	3.3	2500	165.0
September	70	4.5	4900	315.0
October	40	2.9	1600	116.0
November	20	2.0	400	40.0
December	20	1.9	400	38.0
Σ (i.e., the sum of)	450	$34.2	19750	1424.0

The equation for a straight line $y = a + bx$ is then solved where y is the expense, x, the production, a, the fixed component of expense and b, the variable factor of expense. This is done by restating the equation twice: once in terms of the totals of the columns

$$\Sigma y = na + b \Sigma x$$

(where n is the number of items in the total); and once in terms of the aforesaid totals each multiplied by x

$$\Sigma x y = a \Sigma x + b \Sigma x^2$$

These figures are also found at the bottom of the table columns.

Substituting figures for symbols, the first and second equations become:

$$34.2 = 12a + 450 b$$
$$1424.0 = 450a + 19750 b$$

Solving these simultaneous equations by multiplying the first by 75 and the second by 2:

$$2565.0 = 900a + 33750 b$$
$$2848.0 = 900a + 39500 b$$

Subtracting:

$$-283.0 = - 5750 b$$
$$b = .0492$$

Substituting this value for b in the first of the simultaneous equations:

$$34.2 = 12a + .0492 \text{ times } 450$$
$$a = 1.005 \text{ expressed in thousands}$$

or fixed expense is $1005.

The formula is now: Expense = $1005 + .0492 times production in pieces.

The graphical or mathematical methods can be used as a check on the analytical method described previously but should not be used by themselves except under circumstances which are thoroughly understood. The major fault of these methods is that abnormalities will occur in certain months which should not be reflected in the normal fixed-variable relationship but which will find themselves reflected in this approach unless they are specifically eliminated. As an example, the Maintenance Department in a factory may find that its load varies to some extent with production and this would be a normal relationship. However, if this same Maintenance Department were asked to take care of machine overhauls during a period when production was slack, a not unusual occurrence, the result would be to completely confuse the expected relationship. A second fault of these methods is that they tend to perpetuate in management's thinking any past failure on the part of supervision to reduce variable costs as production decreased.

Although the analytical method must be carried out account by account and usually department by department, no such limits exist on the graphical or mathematical methods and accordingly some companies will use the analytical method on each account, add up the results obtained for the entire company, and check the total by means of the graphical technique. The resulting graph which shows total expenses broken down between fixed and variable will be recognized as the basis for a break-even or a profit-volume chart.

Having briefly reviewed the methods of separating fixed from variable costs, it is now appropriate to consider the uses to which the resulting information can be put.

MANAGEMENT DECISIONS

In discussing the various types of management decisions which are helped by a knowledge of the portion of unit costs or departmental costs which are fixed, it should not be overlooked that there are some managements who are not aware of some of their problems. For instance, it is assumed in the following example that management was trying to find out if it was losing money by accepting small orders. There are many companies which have never stopped to consider this problem, but the possibility is always present that orders below a certain size are uneconomic to handle and it may well be that some consideration should be given to such a study. Once a review is undertaken, it quicky becomes apparent that a correct answer requires some knowledge of the fixed and variable components of costs.

In a particular case, a manufacturer found that 80 percent of his volume was shipped on 20 percent of his orders, a fairly common situation. He further found that the smallest 10 percent of his orders had an average sales value of \$6.50. He had previously discovered that his order processing costs including invoicing, recording the account receivable, selecting the merchandise, checking it, packing it, and writing the shipping documents was \$3.00 per order. Since his gross profit averaged 30 percent (which is \$1.95 on a \$6.50 sale) it *seemed* that he was losing money on every such order shipped. He recognized that a small fill-in order for a good customer would have to be accepted regardless of the loss, but he found that there were certain customers whose orders were virtually all of this size. He wanted to know whether these accounts should be discontinued.

The problem was approached from a direct cost point of view. On this

basis it was discovered that his marginal manufacturing profit (i.e., the difference between selling price and variable manufacturing costs) was 50 percent and that this figure was the one he should have used rather than the 30 percent gross profit. This was so because he had included in manufacturing costs fixed overhead which in this instance was 20 percent of selling price, and this fixed overhead was going to be there whether he serviced these particular accounts or not. It also developed that his $3.00 order servicing cost included allocations of fixed supervisory and occupancy expenses, whereas his out-of-pocket order costs for the $6.50 sale were only $1.50. Thus his variable manufacturing costs were $3.25 which, added to his variable order processing cost of $1.50, gave him a total out-of-pocket cost of $4.75. The difference between that figure and $6.50 is the extent to which his profits would be hurt if he ceased to sell customers of this type. In other words, if he dropped these customers the fixed costs which they were partially absorbing (although not entirely) would have to be absorbed by other orders and the company as a whole would have had reduced profits.

Although a number of factors besides costs were considered, such as the effect of dropping small customers upon competition, the building up of new accounts, the opportunity for salesmen to concentrate on the larger accounts, etc., these factors were not determining. Accordingly the decision was made to retain the small accounts. In making the calculation as to which costs should be considered fixed, it was recognized that a cost which would not change through the dropping of a few accounts might very well change if a large number were dropped. The foregoing figures are based on accepting as fixed only those expenses which would not have changed if the entire group of customers which were considered to be "small" had been dropped.

PRODUCT LINE ANALYSIS

Another instance where the recognition of fixed and variable costs can be helpful is in the case of a company which seems to have a number of products which are making money, and a number of other products which are losing as much as the first group makes. One manufacturer had determined to round out its product line by acting as a jobber for certain products it was not equipped to manufacture. On the products for which the company was in effect a wholesaler, it was charging selling and administrative expense at its average experience of 35 percent, which inevitably caused these products to show a loss because the normal wholesale markup was 20 percent and competition forced the company to buy and sell at the prices which were generally accepted in the field.

A direct cost approach to this problem very quickly revealed that the abandonment of the jobbed products would reduce selling and administrative expense less than the 20 percent margin the jobbed products were showing. The study could very well have stopped there, having proven the propriety of retaining the jobbed product lines, but the direct cost approach was carried one step further. A calculation was made to determine what the selling and administrative expense percentage would be on the products which the company manufactured itself if the jobbed products were dropped. The figures indicated that the percentage would then be about 45 percent. Since it was known that this was entirely out of line with other manufacturers in the industry, the study served to draw attention to an

unhealthy situation in the manufacturing part of the business, and remedial steps were taken shortly thereafter.

PRODUCT EMPHASIS

Manufacturers are constantly faced with the problem that their advertising appropriation is too small to be effectively spread over all the company's products. Similarly, there is always the question of which product to ask the salesmen to push and which product to emphasize in point-of-sale promotional material. This question can ordinarily be answered most effectively through a direct cost approach which may be illustrated by reference to Exhibit III.

Exhibit III-A shows a situation in a company as it existed prior to the commencement of a promotion. Under the assumptions made in this example, the company is selling two products, A and B, and it knows that each sells for $10 per unit. On the basis of cost figures already available, it is known that raw materials on Product A are $5, Product B, $3; direct labor on Product A is $1, Product B, $2. Overhead has been allocated in proportion to direct labor, and it has been found that it is necessary to allocate overhead at 150 percent of direct labor in order to absorb it. Exhibit III-A shows that Product A has a gross profit of $2.50 or 25 percent, and Product B has a gross profit of $2.00 or 20 percent.

EXHIBIT III-A

EXAMPLE OF USE OF MARGINAL PROFIT IN PLACE OF GROSS PROFIT IN SELECTION OF PRODUCT LINE TO BE PROMOTED

Situation Prior to Promotion of Either Product

	Unit Costs		Total Costs		
	Product A	Product B	Product A	Product B	Both Products
1. Sales (A—10,000 pcs. B—10,000 pcs.)........	$10.00	$10.00	$100,000	$100,000	$200,000
Costs:					
2. Raw Materials	$ 5.00	$ 3.00	$ 50,000	$ 30,000	$ 80,000
3. Direct Labor	1.00	2.00	10,000	20,000	30,000
4. Variable Overhead	.50	1.00	5,000	10,000	15,000
5. Fixed Overhead	1.00	2.00	10,000	20,000	30,000
6. Total Manufacturing Costs	$ 7.50	$ 8.00	$ 75,000	$ 80,000	$155,000
7. Gross Profit	$ 2.50	$ 2.00	$ 25,000	$ 20,000	$ 45,000
8. Marginal Profit (Gross Profit & Fixed Overhead)	$ 3.50	$ 4.00	$ 35,000	$ 40,000	$ 75,000

Under the assumption that the company has decided to spend a certain amount of money on an advertising campaign for one or other of the products, and that it is estimated that the amount spent will increase the sales of the product on which it is spent by 20 percent, the question is which product to advertise. Since both the dollar gross profit and the percentage gross profit on Product A are higher than on Product B, the company would normally select this product for its advertising effort. The actual change

in unit costs and total costs which would occur is shown in Exhibit III-B, and it will be seen that the gross profit for the company rises from $45,000 to $52,000. However, if the principles of fixed and variable costs are considered, Exhibit III-A will be read differently; then the fact that the marginal profit of Product A is only $3.50 while that of Product B is $4.00 will be controlling. Accordingly the company should decide to spend its advertising money on Product B and Exhibit III-C indicates the result. It is seen that the gross profit in Exhibit III-C is $1,000 higher than that in Exhibit III-B. When it is realized that many companies survive or fail based on differences in profit not much larger than this, the benefit to be obtained from this type of analysis becomes obvious.

EXHIBIT III—B

Example of Use of Marginal Profit In Place of Gross Profit In Selection of Product Line To Be Promoted

Promotion Allocated to Product "A" Based on Higher Dollar and Percentage Gross Profit

	Unit Costs		Total Costs		
	Product A	Product B	Product A	Product B	Both Products
1. Assumed Sales Results (A—12,000 pcs. B—10,000 pcs.)	$10.00	$10.00	$120,000	$100,000	$220,000
Resultant Costs:					
2. Raw Materials (Unit costs from line 2 Exhibit III-A and by multiplication)	$ 5.00	$ 3.00	$ 60,000	$ 30,000	$ 90,000
3. Direct Labor (Unit costs from line 3 Exhibit III-A and by multiplication)	1.00	2.00	12,000	20,000	32,000
4. Variable Overhead (Unit costs from line 4 Exhibit III-A and by multiplication)	.50	1.00	6,000	10,000	16,000
5. Fixed Overhead (Amount in last column from line 5, Exhibit III-A, spread per direct labor in line 3. Unit costs by division by units in line 1 of this Exhibit)	.9375	1.875	11,250	18,750	30,000
6. Total Manufacturing Costs	$ 7.4375	$7.875	$ 89,250	$ 78,750	$168,000
7. Gross Profit	$ 2.5625	$2.125	$ 30,750	$ 21,250	$ 52,000

In reviewing the foregoing example it is important to realize that the assumption here is that neither labor, machine time nor manufacturing space has been considered as a bottleneck. Should any of these be critical, exactly the opposite result would occur in that for every dollar of direct labor spent on Product A there would be a $3.50 marginal profit, whereas it requires $2.00 of direct labor on Product B to produce a $4.00 marginal profit or, in

other words, there is only $2.00 of marginal profit on Product B for every $1.00 of direct labor expended.

MAKE-OR-BUY DECISION

A completely different problem which can frequently be approached on the basis of similar techniques is the well-known "make-or-buy" decision. Quite frequently a purchasing agent will bring up for consideration the fact that an outside supplier has offered to deliver certain parts previously made inside the factory at costs which are lower than the costs assigned to the same part by the company itself. Most of the time the purchasing agents are well aware that they must compare total costs from the outside with out-of-pocket costs inside the factory, but this is not always the case. Where companies are divisionalized, the division manager is frequently quite reluctant to pay another division more than he would have to pay an outsider, and the selling division is equally reluctant to sell on an out-of-pocket or variable cost basis. Once the dimensions of the problem are understood and all the figures agreed upon, it is usually not too difficult to arrive at a solution which will be best for the company as a whole and still not penalize any specific division. Of course, where the necessary machinery or labor is tied up on other work, a company will not infrequently have to buy an item on the outside which it could make more cheaply itself.

EXHIBIT III—C

EXAMPLE OF USE OF MARGINAL PROFIT IN PLACE OF GROSS PROFIT IN SELECTION OF PRODUCT LINE TO BE PROMOTED

Promotion Allocated to Product "B" Based on Higher Dollar and Percentage Marginal Profit

	Unit Costs		Total Costs		
	Product A	Product B	Product A	Product B	Both Products
1. Assumed Sales Results (A—10,000 pcs. B—12,000 pcs.)	$10.00	$10.00	$100,000	$120,000	$220,000
Resultant Costs:					
2. Raw Materials (Unit costs from line 2 Exhibit III-A and by multiplication)	$ 5.00	$ 3.00	$ 50,000	$ 36,000	$ 86,000
3. Direct Labor (Unit costs from line 3 Exhibit III-A and by multiplication)	1.00	2.00	10,000	24,000	34,000
4. Variable Overhead (Unit costs from line 4 Exhibit III-A and by multiplication)	.50	1.00	5,000	12,000	17,000
5. Fixed Overhead (Amount in last column from line 5, Exhibit III-A spread per direct labor in line 3. Unit costs by division by units in line 1 of this Exhibit)	.883	1.767	8,833	21,167	30,000
6. Total Manufacturing Costs	$ 7.383	$ 7.767	$ 73,833	$ 93,167	$167,000
7. Gross Profit	$ 2.617	$ 2.233	$ 26,167	$ 26,833	$ 53,000

CAPITAL PURCHASES

A number of excellent formulae have been worked out to help management evaluate the benefits to be obtained from major capital goods investments. These formulae generally reflect somewhat varying philosophies with respect to return on investment. The typical small company is not presently using any of these formulae and in most cases will probably find them difficult to adopt. Such companies do, however, compare the savings to be expected from new machinery with the cost of such machinery. Quite frequently the problem arises as to when it pays to buy more up-to-date equipment which will require less labor per unit produced. In these calculations the overhead applicable to the difference in labor costs is sometimes treated as part of the labor saving and sometimes not. It seems clear that the proper approach is to use only that part of the overhead which varies with direct labor, such as fringe benefits and other payroll percentages. In most instances the fixed portion of overhead will be much the larger one. It seems obvious that a labor saving machine will not save any of this fixed overhead and may even increase it. Under orthodox accounting the apparent saving in overhead allocated to the operation merely means that the fixed overhead which has been "saved" will have to be absorbed elsewhere in the plant and the effect on the company's net profit of this seeming saving is nil.

USE IN BUDGETING

One of the early improvements in cost accounting techniques was the development of "flexible budgets" for use with a standard cost system. The flexible budget technique is rather simple in that it merely forecasts the amount of certain semi-fixed expenses that should be expected when operating at various percentages of capacity. To illustrate, a department might require a foreman and two assistant foremen at 100 percent capacity; it could get along without one assistant foreman at 80 percent capacity; and could get along without the other assistant foreman at 60 percent capacity. In this situation the plant superintendent is responsible for seeing to it that the schedule is followed, but he is *not* expected to have reduced his costs in this account by 10 percent if operations drop from 100 percent to 90 percent, for the simple season that there is no way of firing 10 percent of three foremen. The flexible budget procedure recognizes this.

The direct cost approach to budgeting permits the preparation of a single budget at the beginning of the year based on estimated average monthly sales. Each account is broken down between its variable and fixed components and the variable components are expressed not only in total dollars but also as dollars per sales dollar. Then in any month the expected costs can be arrived at by multiplying the unit variable cost by actual sales and adding the fixed costs. A great many companies can take advantage of this procedure without adding to the present clerical burden of their budgeting or the work of making monthly comparisons of budgeted costs with actual. The results are substantially more meaningful than under budgeting systems which attempt to compare actual dollar costs with budget dollar costs although the budget was prepared on the assumption of different sales than actually took place. The results are also an improvement over those situations where actual cost percentages are compared with budget cost percentages and no allowance is made for the inflexibility of the fixed costs in both figures.

A WORD OF CAUTION

In each of the foregoing examples it has been assumed that a proper analysis of fixed and variable costs will provide the right answer to a problem. There is no question that this is true over a relatively short period. However, experience has indicated that fixed costs tend to rise with volume if a sufficiently long time-span is considered. Accordingly some caution must be exercised in making decisions where a customer or product is retained or added on the basis that although it is not covering its full share of costs it is contributing something toward the absorption of fixed costs. It is suggested that in decisions of this type the customer or product be critically viewed and every effort be made to replace it with business which will be profitable on a full allocation basis unless the contribution to fixed costs is fairly substantial.

Cooperation and the Audit Engagement

. . . there is no audit engagement in which there is maximum cooperation between the two parties. In most cases, this lack of cooperation is not deliberate but when it is, it is generally because the client feels that the auditor is not sympathetic to his viewpoint. It more often happens because there may be lack of understanding as to the purpose and scope of the audit, or there may be a clash of personalities. There may also be inexperience, incompetence or lack of authority at the point of contact where the work is done. More importantly, it may be because of an inadequate conception of the relationship between client and auditor and of the principle of independence of the auditor.

The misunderstanding often starts at the very top. Auditors and general management men ofttimes speak different languages. It is surprising, but true, that even some few accountants in private industry lack a clear idea of audit procedures and practices. It is not infrequent that auditors have been engaged by men of industry who have preconceived ideas as to what the audit is to accomplish and how it is to proceed. There are those who have, even after several audits, only a general understanding as to what is involved in an audit. To them, cooperation may mean "give the auditor what he asks for but don't volunteer information," or "give him the records and let him work it out" or "let him do what he wants as long as he doesn't interfere with the routine." A mistaken idea that volunteered information or assistance is a violation of the auditor's independence, no doubt, has fostered this reluctance on the part of the client to go beyond the requests of the auditor. In my opinion, a higher conception of cooperation as joint planning and working together toward a common goal, is a legitimate and workable relationship which needs to be more fully explored in most audit engagements.

R. E. Wilgus, "Cooperation Between the Public Auditor and his Client," Bulletin of the Georgia Society of CPAs, May 1959

New York State Tax Forum

Guest Editor—Woodrow W. Rill, CPA

DECLARATION OF ESTIMATED TAX

During the 1959 session of the New York State Legislature a number of tax bills were passed, many of which were to conform the state statute to the Internal Revenue Code. One of the new provisions, which probably will affect most taxpayers and which will require the services of the accounting profession more than any other, is the requirement to make declarations and payments of estimated income taxes. The purpose of this discussion is to point out the many differences between the federal and state statutes with respect to declarations and payments of estimated tax; to one who is not cognizant of such differences, the cost could be great.

FILING OF DECLARATIONS

Firstly, the requirements pertaining to the *filing* of declarations are different. In most cases, the federal requirement for filing is met if a taxpayer's gross income includes more than $100 from sources other than wages, and if his total gross income exceeds the sum of $600 times the number of exemptions, plus $400; whereas the state requirement is not met until the combined gross income other than wages and net capital gain exceeds the sum of $600 times number of exemptions, plus $400. The requirement that a declaration be filed when gross income exceeds $5,000 for a single individual or married individual not entitled to file a joint declaration, or when gross income exceeds $10,000 for a married person entitled to file a joint declaration with his spouse, is substantially the same in both cases. However, this federal rule is not applicable where more than $100 is from sources other than wages, in which case the first formula mentioned above is to be used. A married taxpayer with two children and having interest income of $125.00 and wages of $9,800, a gross income of $9,925, would be required to file a federal declaration because his income from sources other than wages exceeded $100 and his gross income exceeded $2,800 ($600 times four exemptions plus $400); however no state declaration would be required because his income from sources other than wages did not exceed $2,800 and his total gross income did not exceed $10,000.

Both the federal and state statutes provide one method for determining the amount of underpayment of an installment of estimated tax. Each provides that the underpayment is the excess of (a) the amount of the installment payment that would be re-

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Ed. Note: For an interim period, until a permanent departmental editor has been selected, this department will be conducted by guest contributors.

quired if the estimated tax were 70 percent of the actual tax for the year, over (b) the amount of the installment paid by the due date; however, in the case of a farmer, the federal statute substitutes 66⅔ percent for 70 percent.

METHODS OF COMPUTING ESTIMATED TAX

The federal statute prescribes five permissible methods of computing an estimated tax and if the taxpayer meets the conditions of any one of the five, then there shall be considered to be no underpayment. The state statute prescribes only two methods, one being identical with the federal rule that the estimated tax be equal to at least 70 percent of the actual, and the other, that the estimated tax for current year be equal to the tax of the preceding year. However, as to the latter rule, the federal statute refers to "the tax shown on the return of the individual for the preceding year" whereas the state statute refers to "the tax of the individual for the preceding taxable year." A taxpayer whose income is unpredictable or is expected to increase would probably avail himself of this latter method of basing his estimate on the tax of the preceding year. For federal purposes such method is a safe one because all the taxpayer has to do is to pay at least the amount of *tax as shown on his preceding year's return,* but to rely on such a method for state purposes might be dangerous since an additional assessment of tax would entail failure to meet the conditions of the alternative method. Inasmuch as the measure of underpayment is based on the aforementioned 70 percent of the current year's tax there could be a considerable "penalty."

ADDITIONAL CHARGE FOR UNDERPAYMENT

Both the federal and state statutes provide that there shall be added to the tax an amount determined at the rate of 6 percent upon the amount of underpayment for the period of the underpayment. The federal statute states that the rate is 6 percent *per annum* whereas the state statute does not have the words "per annum" so it would appear that a flat rate of 6 percent could be charged regardless of the length of the period of underpayment. The Federal statute contains a definition of the term "period of underpayment," but no such definition is included in the state statute. The absence of a definition may imply that the 6-percent charge is to be determined without regard to the length of period of underpayment.

Is the additional charge because of underpayment, a tax, a penalty or interest? The provision is in subdivision 3 of Section 376 of the New York Tax Law and the caption of 376 is "Penalties, additional taxes and interest." In the nine subdivisions of Section 376, the words "penalty" and "added to the tax" are used frequently, but there appears to be no direct reference to "interest." In the case of the federal charge for underpayment, it would make no difference whether the additional amount represented tax or penalty because in neither circumstance would the amount be deductible in determining federal taxable income. There could be considerable difference in the result with respect to the charge made under the state law. If it is a penalty, the amount would not be deductible for either federal or state tax purposes; if it is merely an addition to the state tax, then such amount would be deductible in determining federal taxable income; and, of course, if it is interest, then it would be deductible in determining both federal and state taxable income. On March 11, 1959, the Department of Taxation and Finance published an informal

question and answer booklet in order to acquaint taxpayers with the more important provisions of the new law. Item 73 of the questions and answers states that *"6% interest* is imposed where the taxpayer substantially understates his tax;" however, a further statement is made that "As a practical matter, the *penalty* can be avoided in most cases by filing amended declarations . . ." (Emphasis added.) Item 74, in answer to a question as to whether a taxpayer simply pays his entire tax on April 15 if he failed to file a declaration, states that "If he was required to file a declaration and fails to do so, a 6% penalty is imposed. In addition, he is subject to criminal penalties."

Many taxpayers who receive wages subject to the withholding of federal income taxes do not file declarations of estimated federal tax where the amount of withholding equals at least 70 percent of their tax liability, because there would be no underpayment and there is no penalty for failure to file a declaration even though under such circumstances the Internal Revenue Code may provide that a taxpayer *shall* make a declaration. Unlike the federal statute, the state statute provides that where an individual without fraudulent intent, fails to make, sign or certify any return or declaration of estimated tax within the time prescribed, he shall be liable to a *penalty* of not more than one thousand dollars. That appears to be a pretty stiff penalty, especially if all the tax has been paid through withholding; whether the State Tax Commission will actually impose such a penalty except in very unusual circumstances is a matter of conjecture, but certainly this provision should not be overlooked by the taxpayer or his accountant. The State Tax Commission has announced that where the total estimated tax, after deducting the amount to be withheld, is $40 or less, the taxpayer may file his declaration at any time on or before January 15 of the succeeding year. Even under this last situation, a declaration is required to be filed unless the taxpayer files a final return, accompanied by full payment, by January 31.

DATES OF WITHHOLDING AND INSTALLMENT PAYMENTS

The Internal Revenue Code provides that for the purpose of determining the time of payment and amount of taxes withheld on wages, an equal part of the total for the year shall be deemed paid on each installment date unless the taxpayer establishes the dates on which individual amounts were actually withheld. This provision has afforded a means whereby a taxpayer has been able to avoid penalty for underpayment of tax for a prior installment merely by having his employer withhold additional taxes in the latter part of the year. No such provision is included in the state tax law and on what date the tax withheld may be considered to be paid is uncertain.

JURATS ON DECLARATION FORMS

Most taxpayers base their declarations either on 70 percent of the anticipated actual tax or on one of the alternative methods which entails the lowest payment; still neither the federal nor the state declaration form specifically provides for any one of such methods. This may require a taxpayer either to declare his entire estimated income tax or to make notations on the form as to the basis used for his estimate in order to avoid signing what might be construed to be a false statement. Either the body of the forms should be revised or the jurat omitted and, in the latter case, a signature might be required merely for identification purposes.

Accounting at the SEC

Conducted by Louis H. Rappaport, CPA

With the current bull market, there has been a rash of offerings of securities of small, privately-owned companies. In some of these offerings, the reports of the certifying accountants disclose that in prior years the accountants did not observe the taking of physical inventories.

In a privately-owned company, the management may also be the owners of the business, and, having no responsibility to other owners, management is sometimes willing to settle for less than a conventional, unqualified accountants' report if it means a reduction in the audit fee. Management may limit the scope of the accountants' examination by asking the accountants not to observe the taking of the physical inventory or not to confirm receivables.

In the long run we think this kind of management policy is penny-wise, pound-foolish. Management can rarely be absolutely certain of what need they may have for fully certified financial statements. It is impossible to predict what event or transaction may arise in connection with which they should be able to furnish conventionally certified statements. How much better it is to furnish a "clean" certificate when called upon to do so, rather than explain why a qualified certificate is all that is available. Certainly a certificate based on the usual examination costs more than one based on a limited examination, but the client gets more, too!

If management decides to register with the SEC preliminary to a public offering of securities, the certifying accountant may have a real problem in satisfying himself as to intervening inventories if his examinations in prior years have been limited in scope. Bear in mind that the law and the regulations call for *certified* financial statements. If the accountants' report contains an important qualification running to inventories, for example, the SEC may well take the position that the statements are not *certified.*

Accountants who have been faced with this problem have endeavored to resolve it in many different ways, and their reports reflect the differences in approach to the problem and its resolution. We do not propose to review or summarize these reports. We should, however, like to bring to our readers' attention a recent auditor's report which is decidedly off-beat.

The accountant's problem in this case existed in relation to the statements for the year 1956 of a company acquired by his client in 1957 in a transaction which, for accounting purposes, was treated as a pooling of interests. Hence, the 1956 financial

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statements included the acquired company. This is what the accountant said in his report:

We have examined, etc. . . . Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances, except as set forth in the following paragraph.

We did not examine the financial statements for the year 1956 of one of the companies acquired in 1957 which acquisition for accounting purposes was treated as a pooling of interests. The amounts of net sales and net income of that company were approximately 10% and 6%, respectively, of the totals shown in the statement of income of (name of company) and consoli-

dated subsidiaries for the year 1956. The accounting policies and procedures of the acquired company were reviewed by us and we inquired into the determination of inventories at the beginning and end of the year to ascertain the basis of valuation used. Our review and inquiry disclosed nothing that would indicate that the accounts of the company from which its statements of income and accumulated earnings for 1956 were prepared were not maintained in accordance with generally accepted accounting practice.

In our opinion, with the comments in the preceding paragraph, the accompanying balance sheets and statements of income, additional capital and accumulated earnings present fairly the financial position of (name of company) and the consolidated financial position of the Company and consolidated subsidiaries at November 30, 1958, and the results of their operations for the period of three years then ended (including on a combined basis for 1956 the operations of the afore-mentioned company acquired in 1957), in conformity with generally accepted accounting principles applied on a consistent basis.

It is difficult to draw conclusions about the accountant's examination solely on the basis of the certificate as it appeared in the printed prospectus. It may well be that the accountants did much more to satisfy themselves regarding the operations in 1956 of the acquired company than appears from their report. The report, however, is silent in respect of the *auditing* procedures employed, and seems to be limited to an inquiry regarding certain *accounting* policies.

Perhaps the accountants believed that a company which contributed 10 percent of the sales and 6 percent of the income in the first year of the three-year period covered by the statements was not material. Nonetheless the accountants may have wanted whatever protection might be afforded by the disclosure that they did not audit the acquired company for 1956.

The report appears in a prospectus filed with the SEC which became effective recently.

Administration of A CPA Practice

Conducted by MAX BLOCK, CPA

FURNISHING ANNUAL TIME STATEMENTS TO EMPLOYEES

Consideration should be given to the idea of furnishing every staff accountant (and perhaps other personnel, too) with an annual time accounting. It would show, basically, the number of days worked, the number of days not worked and paid for, and the number of days not worked and not paid for. The statement, which could be a simple, filled-in mimeographed form, could be distributed with the W2 copies, attached to bonus checks, or issued at any other time propitious in the individual case.

What purpose will this serve and will it warrant the effort involved? Each practitioner must decide this for himself but here are some considerations.

1. Employees are not fully aware of their effective pay. Only if they relate time actually worked with the total compensation disclosed on the W2 form do they realize what they receive for each day worked.

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2. The tendency to expect more and more days off can be counteracted only by an intelligent presentation of the fact that the number of days worked are already less than two-thirds of the yearly total, in most cases. This means more than one day off out of every three days of the year.

3. Improper attitudes toward the adequacy of bonuses may be corrected upon the realization of the number of non-working days for which the employee was nevertheless paid.

SAVING AN HOUR EACH DAY

Hours may be measured by the clock, or by the accomplishments of the individual. Careful planning and execution of each day's work may add as much as one extra hour's achievement, without stretching the working day. A program for accomplishing this objective was prepared by Mr. Paul Talbot for readers of the United Business Service and is here reproduced because it is deserving of attention by all practitioners who spend much of their time in their offices.

How often have you wished you could find an extra hour in the day? Many times, I am sure.

Well, if you insist on being literal, it is pretty difficult to do. But you can accomplish much the same result by heeding a few of these suggestions:

1. Keep your desk orderly and reasonably free of "old" material.

2. Act on each item as it crosses your desk instead of shuffling it somewhere. If

some postponement is indicated, do so definitely. Don't just leave it around.

3. Organize your work—including the things that are to be passed along to others for execution. Their time is valuable, too.

4. Be businesslike with visitors, salesmen or fellow-employees who may tend to linger. It is YOUR work that isn't getting done while they chit-chat.

5. Do most of your "must" work in the mornings. Try to have a little more leeway in the afternoons.

6. Use the last 10 minutes of your business day to tidy up your desk and your mind for next day's problems and program. Decide which items rate priority and tackle them first in the morning.

Saving time is not easy—you have to work at it—but it can be done. A reasonable following of these six guides should give you that "extra hour" in the day.

BUDGETS OF AUDIT ENGAGEMENT TIME

In a recent issue of this department there was discussed the importance of estimating the time required for each audit engagement and eventually comparing the estimate with actual time.

In response to a request for copies of forms in use, Mr. Charles S. Rockey, CPA, graciously responded with a form used by his firm. With his permission it is here reproduced.

The utilization of the budget data varies with the billing basis of an engagement. If a per-diem billing arrangement exists, the major value of the budget is in programming men and time. Even in such cases one must be concerned with the reasonableness of the aggregate time because of the concern with not exceeding a client's own budget or concept of a reasonable audit fee. In that event a time estimate should be prepared.

Where, however, a fixed fee or maximum fee arrangement is in effect it is most important for the practitioner to know how much time can profitably be allotted in each staff area. Variations from the budget should, of course, be investigated for the information that can thereby be developed.

ASSIGNMENT REQUEST AND TIME AND EXPENSE BUDGET

From:						Client:
	CSR	DMF	SVY	RC	LJK	
	LW	WC Jr.	HES	RLC	DEL	
	NJR	GFI	HKG	EFJ		

Monthly		3 Months		6 Months		Annual		Tax Returns		Special	
1/31	2/29	3/31	4/30	5/31	6/30	7/31	8/31	9/30	10/31	11/30	12/31

BILLING ARRANGEMENTS

Fixed Fee ( ) Amount $______ Period ______ on a/c bill ( ) By what date? ______

Other:

	Budgeted			Billed			Special Services Billed		
	Hours	Rate	Total	Hours	Rate	Total	Hours	Rate	Total
CC Group No. 1									
" 2									
" 3									
Reviewing, typing, etc.									
Expenses (1)									
Total									
Firm fee									
Total fee (1)									
Billed Date:									

(1) Excluding expenses billed separately.

Date work to start--preliminary: Final

Partners or staff members desired and dates: Possible variance--Earliest Latest

(x before name designates key men)

Assigned and dates

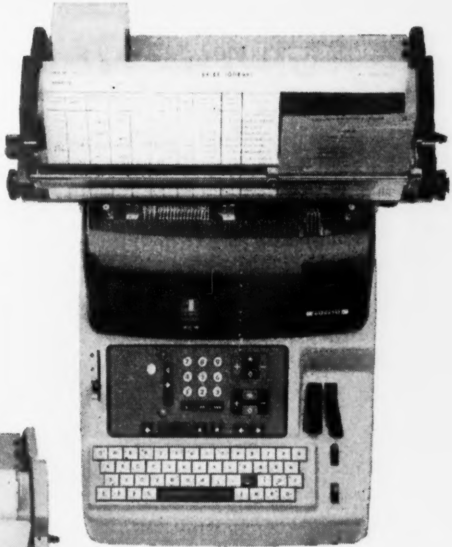
Period Covered:
From
To

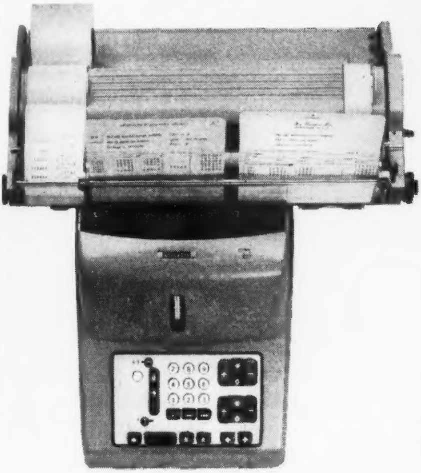
It will be observed that the form is in the nature of a summary and not a worksheet containing the details that lead to the totals. Moreover, the form goes beyond the time element, including an estimate of expenses, and provision for information as to billings. The use of a "firm fee" in the estimate is an interesting concept.

In preparing the "Assignment Request and Time and Expense Budget," the partners provide for an orderly projection of assignments to meet the requirements of clients, to utilize the services of staff members efficiently, and to keep performance within time and expense budgets.

Normally, each assignment request should cover a billing period, or provide for interim or on-account billing during the projection period. If an assignment request provides for work to be done between September 1 and December 31 as part of a calendar year examination, on-account billing may be designated on or about December 20. An assignment request for a monthly engagement should cover each billing period and may provide for interim billing on account. An assignment request for a special engagement should provide for billing either during or at the conclusion of the engagement, or both, as circumstances may warrant.

The CC Groups (cost card) relate to the classification of partners, senior and junior staff members and their hourly billing rates as projected on the cost cards. The period mentioned at the top of the form relates to the billing period while the period designated at the bottom of the form pertains to the period of the assignment request which may run from June 1 to October 1. "Billed time" is the actual time spent on the engagement during the period of the assignment request. The time data comes from the record of the actual time spent on an engagement, as set forth on the cost card.





Payroll Tax Notes

Conducted by SAMUEL S. RESS

VOLUNTARY CONTRIBUTIONS TO EFFECT UNEMPLOYMENT INSURANCE TAX SAVINGS

Accountants and employers who are dissatisfied with assigned New York State unemployment insurance tax rates, may be interested in the establishment of a system of control to safeguard against improper charges to the Employer Account and to take advantage of the new "voluntary contribution" provision in the law to effect tax savings.

The purpose of setting up the Employer Account for each taxpayer is to measure the employer's Benefit Experience Factor, the principal element in the state formula for determining the tax rate. If the account is kept properly, the amount of "voluntary contribution" required to secure a lower tax rate may be determined.

The employer account is credited with the Initial Account Balance and with all timely contributions other than subsidiary contributions. It is debited with all benefits paid to former employees and chargeable to the account of the individual employer. It is also charged under certain conditions with amounts diverted to the General Account of the Unemployment Insurance Fund.

Tax payments cannot be credited to the Employer Account but must be credited to the General Account if received by the state more than 60 days after the due date prescribed by regulation, and after determination and demand for payment has been made by the Industrial Commissioner. Late payments of contributions adversely affect the employer's future tax rate.

Diversion Charges to the individual Employer Account became permissible for the first time on and after June 30, 1959. The amount of Diversion Charges to the individual Employer Account must be determined before the accountant may be able to compute the amount to be paid in voluntary contributions after June 30, 1959 in order to effect tax savings in the form of a lower tax rate for the following year.

If the ratio between the balance in the General Account and the total of all Insured Payrolls of all employers in the state falls below 1.4 percent, there are diverted from each individual Employer's Account to the General Account certain amounts ranging from 1/10 of 1% up to ½ of 1% of the individual employer's payroll. These debits to the individual Employer Ac-

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count are known as Diversion Charges.

When Diversion Charges are made to the individual Employer Account, if not taken into consideration for the purpose of making a voluntary contribution, the expected tax saving may not materialize for the employer because the amount of the voluntary contribution was insufficient to bring about the desired result.

The establishment of a benefit control system to safeguard against improper charges to the Employer Account should include provision for the checking and follow-up of claims filed against the account, and for the periodic analysis of the experience rating charges to the account. Where the same appear excessive, appropriate remedial action should be taken by making proper and timely protest against erroneous charges and for excessive benefit payments for prolonged periods or under other conditions which may not be allowable under the law.

Furthermore, checking and review of the unemployment insurance tax rate assigned to the employer each year should be made part of the audit program. It may be advisable to make an initial survey of the employer's unemployment insurance methods and procedures.

PENALTY FOR FAILURE TO FILE TIMELY REPORT OF CLAIMANT'S EMPLOYMENT DATA

In Appeal Board Case No. 69,717-59, the Industrial Commissioner appeals from a decision of the Referee overruling the determination of the Industrial Commissioner assessing a penalty against the employer pursuant to Section 575.2 of the Unemployment Insurance Law for failure to file a report of claimant's employment and wages within seven days after demand.

On November 14, 1957 a request for employment and wage information was mailed to the employer with respect to a former employee. The employer failed to comply with such demand within the time prescribed by the statute. The information demanded was received from the employer in an envelope postmarked December 3, 1957. Thereafter, a determination was issued assessing the employer with a penalty in the amount of $10 pursuant to the provisions of Section 575.2.

The referee, in overruling the determination of the Industrial Commissioner, accepted the statement of a person associated with the employer's accountant, that the employer did not receive the request for the data in due course after it was mailed on November 14, 1957, possibly because such mail was misdirected.

The person who appeared on behalf of the employer admittedly had no personal knowledge of the facts. No suggestion was made by him that he was the one in charge of receiving mail on behalf of the employer. His suggestion that the mail may have been misdirected was deemed mere conjecture by the Appeal Board and the determination of the Commissioner was sustained.

It is likely that the Appeal Board would have found in favor of the employer in this case and eliminated the penalty had there been testimony by the witness for the employer that the witness was the person in charge of receiving the mail in behalf of the employer and that the notice demanding the wage and employment information had been misdirected and not received by the employer on time.

Two cases involving the right of principal stockholders to collect unemployment insurance benefits even though the claimants continued to hold their capital stock interest in the former employer corporations were decided in favor of the claimants involved.

Federal Taxation

Decisions and Rulings—BERNARD BARNETT, CPA
Guest Editor

Commentary —Committee on Federal Taxation
Chairman, HERBERT M. MANDELL, CPA

DECISIONS AND RULINGS

REOPENING OF CLOSED CASES

Under the 1952 reorganization of the Internal Revenue Service, cases closed by the Auditing Division are subject to several reviews. One review is by the regional analyst who reviews on a selective basis taxpayer settlement files for the following reasons: (1) to determine whether the settlements have been based on a proper interpretation of the law, and (2) to determine the adequacy of the audit procedure. Another review which may lead to the reopening of cases is that of the Internal Audit Division of the Inspection Service, working outside the operations line of authority. (TIR No. 160, May 27, 1959.)

Commissioner of Internal Revenue Dana Latham adverted, in this TIR, to the confidential Internal Revenue Manual procedures with respect to the reopening of closed cases. He stated that the policy of the Internal Audit Division of the Inspection Service on closed tax cases as defined in the Internal Revenue Manual is as follows:

> Internal Audit does not and will not superimpose its judgment as to technical determinations on that of technical personnel, nor does it have the authority to reopen or require the reopening of any closed tax case. The authority to reopen closed cases is vested in operating officials only.

The operating officials in whom this authority has been delegated by the Commissioner are the district director, regional commissioner and assistant regional commissioner (Audit). The TIR continues:

> Commissioner Latham said the Regional Analyst's review of examined closed cases is for the purpose of discovering and identifying the kinds of procedural and technical errors which occur most frequently so that appropriate measures can be taken to improve the quality, technical adequacy, and uniformity of the *entire audit activity*.
>
> It is *not* designed, he said, to check individual agents, and since good tax administration demands that closed cases should not be reopened without strong cause, it is Service policy not to reopen cases closed in the District Director's Office unless they involve errors that are substantial, both in amount and in relation to the taxpayer's total liability, or unless there is evidence of fraud or collusion.

This subject was dealt with at considerable length more than two years

ED. NOTE. Richard S. Helstein, CPA, will resume his regular editorship of this department with the October 1959 issue.

ago in the Progress Report of the Mills Subcommittee on Internal Revenue Taxation (Internal Revenue Administration, Progress Report to Committee on Ways and Means, April 22, 1957). In its report the Subcommittee noted that a material obstacle to the settlement of tax cases is the knowledge on the part of the examining officer and the taxpayer that a case may be reopened after being closed by the Auditing Division. The Subcommittee expressed the view that while a review of closed cases is desirable in the interest of uniformity, the reopening of cases where no fraud or collusion is involved appeared to be unjustified.

The Subcommittee's report reproduced a memorandum from the then Commissioner of Internal Revenue Harrington to all regional commissioners and district directors, dated March 15, 1957, which closely paralleled the wording of the Internal Revenue Manual previously quoted. The Service further advised the Subcommittee that review of a technical issue in a closed case was not considered to be a proper function of Inspection Service employees, but that in the past "reopenings may have been caused in the reorganizational process by reason of excessive zeal or misunderstanding of their functions." In its report, the Subcommittee expressed its conclusion that the existence of a review of closed cases outside the examining officer's own chain of command has a tendency to prevent the exercise of independent judgment by the examining officer. The Subcommittee stated further that the taxpayer's willingness to settle is also affected if he knows that the settlement may be upset even on a minor point without the examining officer's line of command.

In an interesting sidelight, the 1957 Subcommittee hearings produced the statement by Assistant Commissioner (Operations) Stowe that, as a practical matter, cases settled by the Appellate Division are not subject to the reopening procedure provided that the settlement was not obtained by fraud or material misrepresentation of fact. Such a settlement reached in the Appellate Division can normally be considered a final one, safe from reopening by either the Service's regional analysts or Internal Auditors of the Inspection Service.

SUPREME COURT RESOLVES DEALER RESERVE CONFLICTS

The determination of when income properly accrues is of vital interest to CPAs. Not always does the interpretation of tax law conform to generally accepted accounting practice. In November, 1958 this department (Commentary section, page 840) discussed the dilemma faced by installment dealers in such items as automobiles when confronted with the Treasury Department's contention that amounts withheld and credited to "dealer reserve accounts" by finance companies discounting installment paper constitute income at the time the amounts were credited on the books (Rev. Rul. 57-2). The amounts in the dealer's reserve account, retained to take care of possible losses, is not generally available to the dealer when credited. The usual stipulation that the amount of the reserve has to equal a certain percentage of the total installment paper outstanding raises the barrier to availability. Dealers keeping

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their books on the accrual basis have normally deferred the amounts in such reserves and have not reported them as income until they become unqualifiedly available.

Code Section 446 gives the taxpayer the right to use the accrual basis of accounting. A succinct definition of the term "accrual basis" is found in the *Spring City Foundry Co.* case (292 U. S. 182 (1933); aff'g CA-7, 67 F. (2d) 385). In this decision Chief Justice Hughes stated: "Keeping accounts and making returns on the accrual basis, as distinguished from the cash basis, import that it is the *right* to receive and not the actual receipt that determines the inclusion of the amount of gross income. When the right to receive an amount becomes fixed, the right accrues." Using this line of reasoning the contention of the Commissioner, usually supported by the Tax Court, that the balances in the dealer reserve accounts constituted income was tested in a number of cases before seven of the eleven U. S. Circuit Courts of Appeals with conflicting results. Only two of the Circuits ruled in favor of the Commissioner; five held that the dealer did not have to report the "dealer's reserve" as income until it is payable to him.

Based upon appeals from Seventh, Eighth and Ninth Circuit cases, the U. S. Supreme Court has now resolved the controversy in favor of the Treasury Department. In *Hansen, Baird, Glover,* __ U. S. __, 6/22/59 (rev'g *John R. Hansen,* CA-9, 258 F. (2d) 585; rev'g *Burl P. Glover,* CA-8, 253 F. (2d) 735; aff'g *Clifton E. Baird,* CA-7, 256 F. (2d) 918) the Supreme Court rejected the argument that the substance of the transactions was a loan from the finance companies and banks to the customers, and viewed the matter, rather, as a sale of installment paper. It ruled that the amounts reserved and recorded as liabilities to dealers on the finance companies' books constituted a fixed right to receive the reserves. The Court, paraphrasing Chief Justice Holmes, further stated that "it is the time of acquisition of the *fixed right to receive* the reserves and not the time of their *actual receipt* that determines whether or not the reserves have accrued and are taxable." The Court, admitting that the funds in the reserves were not presently available to the dealers, commented that they were nevertheless owned by the dealers and that "it is a normal result of the accrual basis of accounting and reporting that taxes frequently must be paid on accrued funds before receipt of the cash with which to pay them."

In this latest case, the Court has once again upheld and emphasized the Commissioner's broad powers in determining whether accounting methods used by a taxpayer clearly reflect income (*Arthur M. Brown,* 291 U. S. 193 (1934); *Automobile Club of Michigan,* 353 U. S. 180 (1957)) and the Commissioner's right, believing that an accounting method employed "does not clearly reflect income," to require that "the computation shall be made in accordance with such method as in [his] opinion . . ., does clearly reflect the income" (Sec. 446 (b), IRC 1954).

EMPLOYEES' MOVING EXPENSES

An individual moving from one place to another to accept new employment must of necessity incur expenses. These expenses will include the cost of moving himself, his immediate family, household goods and personal effects. The employee, already employed, also is faced with similar costs when his permanent place of employment with the same employer is changed. Oftentimes the new or continuing employer will re-

imburse these moving expenses. At other times, particularly in the case of new employment, the individual must bear these expenses himself.

Any such moving expenses borne or reimbursed by the employer are deductible by him. Such disbursements would constitute ordinary and necessary business expenses. On the other hand a question arises as to the taxability of any reimbursement received by the employee from the employer. Here the Treasury Department and courts have set forth a definite pattern. Reimbursed moving expenses received from a *new* employer are taxable to the employee (Rev. Rul. 55-140); *Sherrill O. Woodall, et al.*, 255 F. (2d) 370 (1958), cert. denied 358 U. S. 824). Amplifying this position, the Internal Revenue Service in its recently issued Rev. Rul. 59-236 has made it clear that the expenses of an employee's moving from one location to another in order to take up *new* employment are personal expenses and not deductible by the employee whether they are paid for him or reimbursed to him by the employer. The ruling emphasizes that any payment by the new employer, whether by way of allowance, reimbursement, or directly to a moving company constitutes taxable wages for Federal Insurance Contributions Act, Federal Unemployment Tax Act and withholding tax purposes.

Where the moving expenses arise because of the transfer of an employee from one place of employment to another place of employment for the *same* employer, the taxability of any reimbursement received depends upon the purpose of the transfer. If the move was made primarily for the benefit of the employer, reimbursements received by the employee do not constitute taxable income to him. In such a case, however, if the moving allowance or reimbursement received exceeds the actual moving expenses, the excess is includible in the employee's gross income (Rev. Rul. 54-429). Where, however, the employee's transfer to a new permanent station is primarily for his own benefit, the moving expense reimbursement represents compensation and is includible in gross income (Rev. Rul. 55-140, *supra; Woodall, supra*).

Moving expenses paid or incurred by an employee in moving to a *new* job in another locality, which are not reimbursed, are not deductible by him. They are considered to be personal expenses (*McClain,* 2 BTA 726 (1925); *Forest W. Rice,* TC Memo 1954-15 (1954)). Unreimbursed expenses paid by an employee resulting from his transfer to a new permanent location for the same employer would also be considered personal expenses and as such not deductible by the employee.

VOLUNTARY SAVINGS PLAN IN CONNECTION WITH A DEFERRED PROFIT-SHARING PLAN

Qualified profit-sharing plans offer substantial tax savings to employees (including stockholder-employees). The corporate employer obtains a current deduction for his contributions to the plan, while the employee is not taxed on his share until a distribution is made to him. Meanwhile, the income earned by the profit-sharing trust is also tax free until distributed at a later date.

Tax savings in connection with deferred profit sharing are even greater when coupled with a voluntary savings plan. Employees, within certain limits, may use the profit-sharing trust as a depositary for their own savings. The income earned thereon is tax free until ultimately paid to the employee, at which time it is subject to capital gain rates, along with the employer's portion, if it is paid in a lump sum.

A recent Revenue Ruling 59-185 outlined the areas within which such a plan may be operated. The Internal Revenue Service permits employee contributions to such plans provided the contributions are not in excess of ten percent of compensation. Of course, the additional contributions voluntarily given by the employees must be used only for the purpose of providing benefits to the individual contributor in addition to the benefits to be provided by the employer's contribution.

Such a voluntary plan is to be distinguished from a pension or profit-sharing plan in which the employee is required to contribute in order to participate in the plan. In these cases care must be exercised to see that the employer contributions are not so large as to be burdensome for lower paid employees and thus discriminatory in favor of highly paid employees. The Internal Revenue Service has ruled that a requirement of employee contributions in excess of six percent of compensation will be deemed presumptively burdensome. (Rev. Rul. 57-163.)

COMMENTARY

DEDUCTIBILITY OF PRIOR YEAR STATE TAXES

The proper year for deducting prior year state taxes by accrual basis taxpayers has become a very important problem for multi-state corporations as a result of two recent Supreme Court decisions (*Northwestern States Portland Cement Co.* v. *Minnesota*, U. S. Sup. Ct. No. 12, February 24, 1959, and *Commissioner of Georgia* v. *Stockham Valves and Fittings, Inc.*, U. S. Sup. Ct. No. 33, February 24, 1959). Under the doctrine established by these cases, a state is empowered to collect income taxes from corporations even though they may not maintain a place of business within the state. As a result, many multi-state corporations will probably be required to pay income taxes to states for prior years where no returns were filed. When will such prior year tax liabilities be deductible by an accrual basis taxpayer?

It seems probable that the Internal Revenue Service will allow the accrual of such tax liabilities in the year in which there is an *acknowledgment of liability* (Rev. Rul. 57-105, 1957-1 CB 193 modifying GCM 25, 298, CB 1947-2, 39). Based on this ruling the deduction would not be allowable in the respective income years if no returns were filed since the liability was not admitted at that time.

The prior GCM held that unpaid contested taxes are not deductible until the controversy is settled. In order to have a "contest," the GCM required a court contest or a bona fide contest lodged with the taxing authorities. However, Rev. Rul. 57-105 expanded the term "contest" so that it apparently includes any situation in which the taxpayer does not volunteer the payment of the tax at the prescribed due date because he believes that no tax is due. Specifically, the ruling holds that a taxpayer cannot accrue additional state taxes until "the amount is finally determined by litigation or default, or *when the taxpayer acknowledges his liability to the State.*" For example, a taxpayer who agrees with the Internal Revenue Service in the year 1958 to an increase in federal taxable income for the year 1956 will not be allowed to deduct the almost automatic increase in the 1956 New York State franchise tax until 1958. It would follow that a multi-state cor-

poration affected by the Supreme Court decisions, which has not filed state returns for prior years, has not admitted liability for such years and accordingly should not be required to accrue state taxes in the respective income years.

Neither does it appear that state tax deficiencies arising from the Supreme Court decisions in 1959 are accruable in the year 1959 *solely* by reason of such decisions, except by the two corporations directly involved in the cases. For example, suppose that in the year 1959 the State of Georgia sends "Multi-State Corp." income tax forms for all prior years and requests completion of the forms and payment of the taxes due thereon, citing the Supreme Court decisions. It would seem that the Georgia income tax is not deductible in the year 1959 if Multi-State Corp. refuses to comply with this request in 1959 on the advice of tax counsel that the Supreme Court decisions are not squarely applicable to it, or that the Georgia income tax law does not by its own terms cover the taxpayer, or for some other reason.

On the other hand, if Multi-State Corp. admits its Georgia income tax liabilities in the year 1959 by an act such as recording them on the books or, preferably, advising Georgia that the returns will be filed in due course, then accruals should be allowed in 1959. If the act of admission is deferred, for example, until 1961, then that should be the year of deductibility.

Of course, if there is any question as to whether an act constitutes an admission of liability (for example, setting up a "Reserve for Georgia Income Taxes"), the deduction should be claimed in the return for the year in which the first such admission occurred. Furthermore, because of a lack of certainty on the question of what constitutes a tax contest, serious consideration must be given to protection against the running of the statute of limitations on the year in which the state first asserts a liability for the tax. In this connection Section 1311 (b)(2)(B) will be useful to protect the taxpayer's rights to a refund if it is subsequently determined that the state tax deficiencies were accruable for a year prior to the one in which the taxpayer claimed the deduction, provided that a refund for such prior year was not barred at the time the return on which the deduction was claimed was filed.

In summary, Rev. Rul. 57-105 seems to move from the position "no accrual for state taxes if there is a *contest*," to the position "no accrual for state taxes if there is no *acknowledgment* of liability." Literally, it appears that a taxpayer who was obviously negligent in failing to file a state tax return and claiming the deduction therefor, might apply the revenue ruling in claiming a deduction in the later year, but it is very doubtful if such result was intended or will be allowed. Caution is also advised in relying on this ruling to defer accruals and deductions for liabilities other than taxes, (e.g., royalties, rents, bonuses, etc.) unless there is a "contest" under

the stricter definition of the GCM. The revenue ruling appears to have been issued for practical reasons (avoiding the necessity of revenue agents adjusting for increased state taxes resulting from federal adjustments) and should be used with reservations in other areas until it has been tested.

EXTENSION OF TIME TO FILE SHAREHOLDERS' CONSENT TO REVOCATION OF SUBCHAPTER S ELECTION

The proposed Subchapter S regulations at Section 1.1372-4(b)(2) provide that a revocation of an election can be made only with the consent of all the shareholders at the beginning of the day of revocation. At Section 1.1372-4(c) it is stated that generally a termination by revocation is effective for the taxable year in which it is made and for all subsequent taxable years if it is made during the first month of that year. If the revocation is not made during the first month of the taxable year, it is effective for the taxable year following the year in which it is made, and for all subsequent years. The timing of an election of revocation obviously can be of great importance.

Recently a corporation decided to revoke its election to be taxed under Subchapter S but one of its stockholders was out of the country and his signature could not be obtained within the required time. An extension of time to file his consent to the revocation of the election was obtained under the provisions of the Internal Revenue Code, Section 6081, which covers other documents as well as income tax returns. Regulations thereunder provide that any person standing in close personal or business relationship to the taxpayer may sign an extension request in any case in which the taxpayer is unable to sign by reason of illness, absence or other good cause. In this

case the request was signed by the corporate president, also a stockholder.

PITFALLS IN BARGAIN SALE

So much has been written about the benefits of sale and leaseback of real property that a few words of caution pertaining to certain pitfalls are appropriate.

Consider a typical closely-held corporation which is in need of working capital and which owns a plant having a fair market value greatly in excess of its adjusted basis. What happens when the corporation sells the plant to a stockholder and then continues to occupy it on a rental basis? True, the corporation now has additional working capital and can deduct the rental on the higher realistic current basis. However, before recommending such a sale, the practitioner should familiarize himself with Regulations Section 1.301-1(j) which provides that if property is transferred to a shareholder (who is not a corporation) for an amount less than its fair market value, then the shareholder is taxed with a dividend upon the difference. This is known as a bargain purchase or bargain sale. Accordingly, the shareholder should be careful that the selling price is not less than the fair market value as of the date of the sale.

Furthermore, the tax adviser should look at Section 1239 which provides that if a sale of depreciable property is made between an individual and a corporation more than 80 percent in value of the outstanding stock of which is owned by such individual, his spouse, his minor children and minor grandchildren, then any gain from such sale of property is taxed as an ordinary gain. Consequently, if the stockholder controls (in the above manner) over 80 percent of the value of the stock, the corporation will not be able to report a capital gain on the sale of the plant. Inasmuch as this section is

limited to depreciable property, that portion of the gain applicable to the sale of the land would still receive favorable capital gains treatment.

LEASEHOLD IMPROVEMENTS BY A RELATED SUBLESSEE

Under Section 178, added to the Code in 1958, the amortization of leasehold improvements in the case of a related lessor and lessee shall be over the remaining useful life of the improvement. A novel question arises as to what period should be used in computing amortization in the following situation. A parent rents land from an unrelated person under the terms of a 40-year lease, without renewal options. It then subleases the land to a wholly-owned subsidiary (a "related person" under Section 178) for a period of 15 years, and the subsidiary constructs a building, having a useful life of 50 years, on the leased premises.

On the basis of the literal language of the Code, it would seem that the period to be used in writing off the leasehold improvements would be 50 years, the useful life of the building. The purpose of Section 178, however, is to prevent an artificially fast write-off of depreciable property by means of leases between related parties. Since the parent in this case could have written the improvement off over its non-renewable 40-year lease, the intention of the law seems to be satisfied if the subsidiary uses that 40-year period rather than the 50-year useful life. The *Fishing Tackle Products Company* case, 27TC 638 (1957), would support this conclusion, although such case was decided prior to the addition of Section 178 to the Code.

NON-RESIDENT ALIEN ESTATE TAX

A non-resident alien is subject to estate tax on that part of his gross estate which, at the time of his death, is situated in the United States. In calculating the taxable estate, only a portion of administration expenses, funeral expenses and indebtedness of the deceased non-resident alien, can be deducted. Section 2106(a)(1) states that the allowable deduction is equal to the portion of the total deductions for expenses and indebtedness which the value of the gross estate situated in the United States bears to the value of the "entire gross estate," wherever situated. It is immaterial whether these expenses and indebtedness were incurred or expended within or without the United States. Estate Tax Regulation Section 20.2103-1 states that the "entire gross estate" of a non-resident alien does not include real property situated outside the United States.

The application of the Code and Regulations, as noted above, may result in unusual determinations. Administration expenses incurred in the country of domicile normally include executors' commissions and legal expenses. In many cases, the amounts of such commissions and legal fees are determined in an amount equal to fixed percentages of the estate administered by the executor. If the estate, situated in the country of domicile of the non-resident alien, includes real property, it is not unusual for the executor's commissions and often legal fees to be based on the total estate including this real property.

Let us assume the following facts with respect to the estate of a non-resident alien:

Gross estate in the U. S.	$ 100,000
Gross estate situated outside the U. S. (excluding real property)	50,000
"Entire gross estate"..	$ 150,000
Real property situated outside the U. S.	$1,050,000

Administration expenses:		
Executor's commissions:		
Commissions on assets in the U. S.—5% of $100,000	$	5,000
Commissions on assets outside the U. S.—5% of $1,100,000		55,000
Total	$	60,000

For simplicity's sake, let us assume that there were no other deductible expenses or debts. The determination of the taxable estate on Form 706NA would be as follows:

Gross estate situated in the U. S.	$100,000
Deduction for administration expenses	40,000*
Taxable estate (before exemption)	60,000
Specific exemption allowable for non-resident alien	2,000
Taxable estate	$ 58,000

* $60,000 commissions x $\frac{100,000 \text{ (Gross estate in U. S.)}}{150,000 \text{ (Entire gross estate)}}$

From the above calculations, it can be seen that, as a practical matter, the major part of the deduction allowed for administration expenses consists of commissions based upon real property located outside the United States, which real property is excluded both from the determination of the gross estate in the United States and the "entire gross estate." This result, however, is the only one which can be arrived at from a literal application of the Code and Regulations. It should be borne in mind that although executors' commissions are normally calculated as a percentage of the estate administered both in the United States and in the country of domicile, these expenses are a general charge upon the estate as a whole, and cannot be considered as expenses directly related to any specific assets.

It should be further noted that the estate of a citizen or resident alien of the United States does not include real property located outside the United States. Yet the administrative expenses attributable to this property are deductible in computing the taxable estate. While it is not usual that a substantial portion of a citizen's or resident alien's estate is made up of real property located outside the United States, such a situation could produce unusual results.

PURCHASE OF "PUT" NOT CONSIDERED DISPOSITION OF STOCK ACQUIRED UNDER RESTRICTED STOCK OPTION

In the July 1959 issue, this department pointed out that an employee may wish to protect himself against the future decline in the value of stock acquired by him through the exercise of a restricted stock option. If the employee exercised his option and then immediately sold his stock he would be denied capital gain treatment on the sale for the reason that he disposed of his stock within six months after acquisition.

It was pointed out that the employee could protect himself against a possible decline in the value of the stock by purchasing a "put," covering the identical shares acquired under the stock option, on the same day the shares are acquired, providing he identifies the shares with the "put."

In July 1959 the Treasury Department, in Rev. Rul. 59-242, affirmed the use of this procedure in holding that the purchase of a "put" to sell stock acquired upon the exercise of a restricted stock option, would not of itself constitute a disposition as defined in Code Section 421(d)(4).

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CPA, who has adopted electronic machine method of posting the G/L that has proved highly time saving and effective seeks association with CPA firm to learn the new technique and be available for overflow work. Box 1801.

CPA, 38, $5,000 practice, good tax background, will purchase accounts or partnership interest, willing to work per diem leading to same. Box 1802.

CPA, AICPA, NYSSCPA, 15 years diversified experience, seeks to become associated with overburdened practitioner or one planning retirement. Box 1804.

CPA, age 45, 20 years diversified experience, has $7,500.00 practice and free time, seeks association for mutual benefit. Box 1806.

CPA, with attractive completely equipped office, lower Westchester, wishes to share it with another practitioner, view to merger. Box 1809.

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CPA, NYSSCPA member, $10,000 gross, two days per week available time, seeks association with overburdened practitioner. Box 1811.

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CPA, 33, 11 years experience in public accounting wishes to purchase either partnership interest, preferred, or practice in N. Y. area, substantial funds available. Box 1813.

CPA, 391 East 149th Street, wishes to share 750 square feet office space with other accountant. Harry Eisenberg, MO 9-0097.

Office Space, midtown CPAs, air-conditioned, suitable one-man practitioner, $60 per month. BR 9-7827.

CPA, 30, extensive diversified experience, desires position or association with overburdened practitioner leading to early partnership. Box 1814.

CPA, 475 Fifth Avenue, N. Y., has private office to sublet, share secretarial services. LE 2-5237.

CPA, N. Y., N. J., AICPA, NYSSCPA, MBA, age 40, $25,000 practice, can arrange 70% free time, seeks merger with larger practitioner, or partnership interest, substantial cash available, and very attractive retirement arrangement. Box 1815.

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